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THE PROBLEM OF THE STANDARD OF  
INDIAN CURRENCY



# THE PROBLEM OF THE STANDARD OF INDIAN CURRENCY

*ITS HISTORY AND SOLUTION*

By  
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## INTRODUCTION

The Currency standard problem has become almost an insoluble one in the modern world. The classical school of economics is dogmatically sticking to its ideal of a fixed value of money but the new-classical school, rather the neo-mercantilist school under the able leadership of Mr. Keynes, holds that the quantity of money is not a matter of indifference. A greater quantity of money leads to a greater volume of employment and national dividend. This restatement of the mercantilist view has rather puzzled the modern world which is oscillating between the two views and is unable to solve the standard problem of its currencies.

Though the solution of the problem is very difficult, still attempts towards it must not be given up as hopeless. I am contributing my own humble quota towards the solution of this vexed problem from the Indian standpoint and the scheme I am proposing for India can be easily generalised and applied to all other countries.

At the present moment about 99 per cent of human activities are economic but the generality of public have no theoretical background to help them in solving their daily problems and they guide themselves according to popular views which have remained virtually unchanged, specially on currency matters, for the last five centuries. Academic economists could not explain their viewpoint to the satisfaction of the public partly because they propounded their theories in the most abstruse manner completely unintelligible to a man in the street and partly because of inherent defects in their theory which compelled them to take shelter under a highly abstract system of reasoning. These charges can be levelled not only against the classical school but also against the new mercantilist school. Keynes in his introduction to the General Theory of Employment, Interest and Money, writes:—"..... I cannot achieve my object of persuading economists to re-examine critically certain of their basic assumptions except by a highly abstract argument and also by much controversy. ..... At this stage of the argument general public though

welcome at the debate, are only eavesdroppers at an attempt by an economist to bring to an issue the deep divergences of opinion between fellow economists. ....”

In the following pages I have considered the problem throughout from the standpoint of an impartial economist. But my arguments, I believe, are sufficiently easy to be intelligible to an ordinary man whom I have always kept in view in examining, in the following pages, the currency history of India from Akbar's time to the present day. Different periods of Indian currency history may be classified under two heads: inflationary and deflationary. It has inevitably been the case that the inflationary periods were prosperous and the deflationary periods were those of depression. The currency history of India therefore lends support to the new mercantilist school that prosperity varies directly with the volume of money.

For this general inference I have not distorted the currency history nor have I taken any perverse view of it. So far as the narrative part of the book is concerned I have not budged an inch from the views of the leading authorities on the subject, specially of Dr. Ambedkar. The reader will at once realize that almost all ~~the~~ inferences have been diametrically opposite to those of Ambedkar and other members of the Bombay School of Economics and their earlier generations of Indian economists. But I have deduced my conclusions from the same set of facts and figures used by them. I am convinced that the inferences I have drawn are the only ones that can be reasonably drawn from those facts and figures and the positively mistaken views of the Bombay School were due to their blind attachment to the classical doctrines and their dogged tenacity to prove those doctrines under all circumstances, pooh-poohing off all the incidents that went against their generalisations.

With the teachings of history in favour of the new-classical school in mind, I examined the case of the classical school of economics for a fixed value for money and found it to be lacking in some fundamental respects. Though a fixed value of money ensures to some extent distributive justice and inflation leads to an arbitrary redistribution of social wealth still an increase of money by lowering interest rate and increasing marginal efficiency of

capital, increases national dividend and therefore net economic well-being. Thus it seems that both from historical and theoretical points of view the new mercantilist school seems to be the torchbearer of truth.

But the analysis of the new mercantilist school however seems to have stopped just short of the bottom of the truth in their laying the whole blame of the trouble at the door of money which has an inherent defect in its liquidity. The possession of money means the right of purchasing anything at any moment but producers can produce only definite things at definite moments. For this reason there develop mal-adjustment of demand and supply and consequent unemployment and shrinkage of national dividend. They therefore like to recommend a scheme of stamped money or inflation in order to deprive money of its liquidity. That inflation in the past led to economic prosperity and increase of national dividend was possible because of the accidental nature of inflation on the one hand and modest degrees of inflation on the other. The adoption of a deliberate policy of inflation will make the sufferers from inflation safeguard future contracts by supplementing those with clauses in kind. In other words people will take recourse to barter. Again, an immoderate degree of inflation will make sellers unwilling to enter into future contracts and will cut at the root of capitalistic production. War inflation, for example, was not attended with any commensurate degree of productive activity. A policy of stamped money also forces society back to barter. Though there is a chance of adjustment of demand and supply still that adjustment will take place with a considerably diminished scale of production and national dividend. Such a policy is clearly retrogressive.

The aim of new mercantilists, specially of Keynes, is also open to objection. He aims at full employment and not optimum level of wealth. Employment or productive activity is a means to some end and not an end in itself. Wealth or consumption is and should be the aim of economic activities and by taking full employment as his aim Keynes has confused the means with the end.

With Keynes I like to hold money responsible for unemployment and a lower level of production below the optimum amount but unlike Keynes I think that these are caused not because

money is liquid but because money is not sufficiently liquid. Interest on money measures the extent of illiquidity that money possesses. To effect an exchange an amount of money is needed for a certain period of time. In an exchange both the parties part with a thing which is less useful for a thing which is more useful. Every exchange, therefore, leads to a net addition to society's welfare so far as commodities exchanged are consumables and a net addition to society's wealth so far as things exchanged are production goods. Interest on the amount of money required for a particular exchange is a deduction from the gain of that exchange and to that extent is a deterrent to exchange. If the gain to be derived from an exchange is less than the interest on money, that exchange will not take place. Abrogation of interest on money will therefore, make exchanges perfectly frictionless and will lead to the best utilization of national resources. Not only positive interest, but negative interest also is incompatible with frictionless exchange. Negative interest, like stamped money or inflation will entangle society into barter and will lead to a lessening of production. Zero interest only will make exchanges perfectly friction-less and lead to the maximum national dividend. At zero rate of interest only, money becomes perfect facilitator of exchange for which it was devised in preference to barter. Money is not money as long as there is any interest on money but is simply a halfway arrangement between money and barter. If at the zero rate of interest also all the labourers are not employed, the superfluous number should be maintained by state subvention or charity rather than by giving employment. The latter method will be more wasteful because it will lead to a diminution of national dividend below the optimum level. Thus it is apparent that insufficient liquidity of money due to the presence of interest is at the root of trouble. I have, in the following pages, suggested a practicable scheme of bringing down interest to zero by manufacturing paper money and having state regulated investment.

This theory of the perfect money necessarily involves a fixed value for money because both inflation and deflation deprive money of its exchange facilitating power. I have shown that my scheme of free and unlimited loans for investment purpose only will not lead to any inflation and is not incompatible with a fixed

value for money. The ideal meaning of the fixed value for money is the fixity of its value in term of composite commodity representative of consumption. That is what I have suggested to be the standard of Indian Currency. My conclusion, therefore, has been that of the classical school.

Thus my theory is a synthesis of the classical theory and the new-mercantilist theory. I agree with the latter and support inflation when investment is less than what is sufficient for securing the optimum amount of national dividend and I fully support the classical view for a fixed value of money without which money cannot become a perfect facilitator of exchange and there cannot be the optimum amount of national dividend.

This book is the result of my last ten years' hard thinking. In the meantime I had to read all the books on currency and banking of the leading authorities on the subject and I am indebted to all of them more or less. Special mention should be made of Marshall, Fisher, Taussig, Gregory, Robertson and Keynes so far as the theoretical part of it is concerned and of Ambedkar, the Currency Commissioners and the Bombay School of Economics so far as the historical part of it is concerned. But my greatest debt is to Keynes without whose latest analysis, this book would not have seen the light of the day. But the elements of truth scattered in the diverse theories had to be synthesised in a co-ordinated and harmonious whole for the real understanding of money.

As this book represents a gradual evolution in my mind I am acutely conscious of its shortcomings. I feel that if I am to write it anew I can do it much better. But perhaps it is worth while publishing it in the form in which it stands now at least for the favour of criticism which will enlighten me further on the subject and help me in improving and developing my thesis. But a few printing mistakes that have unfortunately crept into the book have however worried me very much.

The present sterling standard of India, which has been legalised by the Reserve Bank Act of 1934, is simply a provisional measure and a passing phase and the preamble of the said Act expressly lays down that a permanent standard for the Indian Currency should be fixed up at the earliest possible opportunity.

This book is commended to the Governor and Directors of our Reserve Bank who have been required by clause 55 of the Reserve Bank Act of 1934 to report to the Governor General in Council 'about the suitability of a permanent basis of Indian Currency and to frame measures for the future monetory Standard of India when the international monetory situation becomes sufficiently clear to make it possible to frame such measures.' The international monetory situation seems to have become sufficiently clear by now and surprises in monetory policy of any leading country are extremely unlikely in any visible future. The Governor and Directors of our Reserve Bank have probably already begun to pay their attention to the standard question of the Indian currency. It may be that in this scheme of the Ideal Money they might find their much sought for El-dorado. I do not think that they need hesitate to recommend such a scheme because it is new and untried. If India could lead the world in many matters in the past there is no reason why she should not be able to lead it in the currency matters in future.

Abdus Sadeque,  
Ballygunge, Calcutta.

The 12th December, 1937.

## CORRIGENDA

Page	line	incorrect	correct
1	4	to	with
2	1	fulfilr	fulfil
3	6	weights silver	weights of silver
4	26	have	had
5	17	acceptibility	acceptability
6	29	Exchang	Exchange
7	13	perforce	nil
10	22	form	from
11	21	.They	which
12	4	fulfill	fulfil.
13	27	previous	precious
16	25	acceptability	acceptability
23	17	regulaltion	regulation
23	23	their	there
40	20	ocount	account
58	23	disgrutted	disgruntled
76	22	maniputalition	manipulation
81	5	Reserve	Reverse
83	30	Progress	World prices
94	28	balance Indian	balance of Indian
100	4&29	pasu	passu
102	8	benefitted	benefited
105	6	export	expert
108	28	value gold	value of gold
109	7	instanteneous	instantaneous
112	8	convertibly	convertibility.
114	20	sterlizing	sterilizing
115	26	temper	tamper
121	20	greater	great
126	22	inflation	deflation
132	• 31	arthmetical	arithmetical

Page	line	incorrect	correct
133	30	pasu	passu
142	6	maitaining	maintaining.
146	1	sacrific	sacrifice.
149	25	intercaped	intercepted.
149	29	Denmark	Denmark
151	17	with	at
152	22	merchantilist	mercantilist
153	15	gymnasium	gymnastics
156	2	entreneurs	entrepreneurs
166	11	to found	to be found
166	26	are	is
167	21 & 22	floatations	floatations.
175	22	affected	effected
191	7	fettish	fetish
194	4	desease	disease
195	13	uphemeral	ephemeral
198	27	theoritical	theoretical
201	13	continous	continuous
202	22	obliterates	obliterate
209	20	form currency	form of currency
212	14	furthing	farthing
214	17	if	of
216	25 & 27	temper, tempering	tamper, tampering
217	3	desease	disease
217	27	nagative	negative
218	8	inconviences	inconveniences
218	23	tree	free.
221	30	19th	16th

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THE PROBLEM  
OF  
**The Standard of Indian Currency**

CHAPTER I

THE PERIOD OF  
**Double Standard or Bimetallism**  
(*From Akbar's time to 1873*)

**T**O understand the problem of the standard of Indian currency we should take a historical retrospect as far back as the connection of the present system can be directly established to the systems of the past. It will suffice if we begin from Akbar the Great, the founder of the economic structure of the Moghul Empire, whose currency system may be said to be the direct predecessor of the present one. From his time to 1873, Indian currency system might be styled a double standard or bimetallism. The salient features of this system were the same as those of bimetallism. For this reason we should explain first what a bimetallic currency is and then see how far the Indian system satisfied the conditions of that standard.

Bimetallism is a system of currency, employing simultaneously two metals, gold and silver, to form jointly the standard of value. A complete bimetallic

currency must fulfill two essential conditions: (1) A mint always prepared to coin any amount of gold and silver, brought by the public to it, without any appreciable charge at a given ratio (2) and unlimited legal tender character of both gold and silver monies at that ratio. When bimetallism is introduced, the question arises whether the legal ratio between the two coins tallies with the market ratio of gold and silver between the two metals in the bullion market. If the legal ratio be 1: 16, the silver coins of the same value will be sixteen times as heavy as the gold coin. But if in the bullion market one tola of gold is sold for 15 tolas of silver, no one will bring silver to the mint for coinage because it is more valuable in the bullion form than in the form of coin. In the reverse case, if one tola of gold is sold for seventeen tolas of silver in the bullion market no body will offer gold for coinage because in raw form it is more valuable than in coin form and silver will be the only metal brought forward to the mint. A very slight deviation of the market ratio of the two metals in the bullion market, from the legal ratio, will make people bring only one of the two metals i.e., the legally overvalued one, to the mint while the other metal will be summarily kept out of the mint and currency.

The metal which is brought forward to the mint for coinage is said to be overvalued and the other which is not brought forward is undervalued by the currency authority. The undervalued metal is not only not presented for coinage but also the coins of that metal, if already existing, are melted down. The bimetallic laws do not attempt to determine the values

of the metals in an absolute sense but they try to keep the relative values of the metals at the legal ratio. When silver is coined at a ratio of 16 weights to one weight of gold, the mint offers one weight of gold for 16 weights of silver. But if in the bullion market 15 weights of silver suffice to buy one weight of gold, silver in that case is undervalued by the mint because market offers a higher value for it. In the reverse case, when 17 tolas of silver are required to purchase one tola of gold in the bullion market, silver is overvalued by the mint because in the open market it commands a lower value.

The overvalued metal will tend to be the only member of the currency of the country. A commodity will go to a place where it can command a higher price and so will a money metal do. The overvalued metal only is presented for coinage. This means that its supply in the bullion market contracts. Whenever the supply of a particular thing increases, its value per unit falls and when the supply shrinks price rises. This is a rudimentary axiom of the economic science. The shrinking of the legally over-valued coin in the bullion market tends to push up its price there. On the other hand, the other metal which has been undervalued by the mint cannot be presented to the mint for coinage and the coins of that metal which already exist are melted down and reduced to bullion form which gives it a higher value. The supply of that metal in bullion form increases and its price per unit diminishes. Thus the offer of unlimited and free coinage of the two metals at a fixed ratio has the power of lowering down the price of the undervalued metal and pushing up the

price of the overvalued. This is said to be the compensatory action of bimetallism. But if there is a permanent force that succeeds to keep the value of the overvalued metal lower than the mint valuation, even to a slight degree, for any length of time, the entire currency will be filled up by the overvalued metal and the undervalued metal will completely cease to be the circulating medium and bimetallism will be converted into monometallism. But when bimetallism has broken down, it can be restored by changing the mint ratio in favour of the undervalued metal. When by doing this, the undervalued metal is retained in currency, the total volume of available circulating medium becomes greater and as such value of a given unit of money falls to a lower level. It should be clear by now that it is not possible for any two countries of the world to maintain bimetallism at two different legal ratios. The weaker of the two countries, in the economic sense of the term, will lose its undervalued metal and it will have a currency system of that metal only which she overvalued in comparison with the stronger country. International character of bimetallism is much more patent in its beneficial effects. Even if a single and a very small country can keep bimetallism in operation, all the countries of the world, having gold or silver monies, will be knit up together as if all have got the single currency system. The normal foreign exchange rate between any couple of silver standard and gold standard countries will be the mint ratio of the small bimetallic country. All other countries will enjoy the beneficial effects of bimetallism without being subjected to the stress and strain of compensatory action of that

system. This advantage to the rest of the world will disappear the very moment bimetallism in the supposed small country breaks down.

If a small country—small in the economic sense of the term—wants to adopt a bimetallic currency when such a system is already prevalent in another bigger country or countries, it should simply have free coinage of both the metals and need not fix up any ratio between them. If it does, it must adopt the ratio already existing and must always be alert to adopt any change in the ratio adopted in the bigger country or it will lose the metal undervalued in the new ratio.

The above is the ideal and legal definition of bimetallism. But the popular definition of bimetallism is more elastic and is couched in economic phraseology only. In this popular form free minting and general acceptability of both the coins are the only essential attributes and there need not be any fixed ratio between them. Of course, market conditions will bring about a ratio between them and a change in that ratio, brought about by market conditions, should simply be accepted, by the Governments. In this popular form, bimetallism was the system of currency of the world from the time of the discovery of the Spanish American mines to 1873.

Before the discovery of the Spanish American mines and in a much more pronounced manner after that discovery, both gold and silver monies were used concurrently in almost all the countries. Monies of both the metals were also interchangeable, though not always at a fixed ratio. Silver was found in greater abundance and consequently it was cheaper. For these

reasons silver was more widely used as money than gold. The two metals were coined independently and they were let free to determine the ratio between them by market conditions. At first it was parallel-system rather than bimetallism. But market conditions could not but determine a ratio between them at any particular time and any ratio fixed up at a particular moment became sticky for a good length of time. Minor deviations of their market ratio from the then existing money ratio were corrected behind the scene by compensatory action and till serious relative change in the conditions of production of the two metals overtook the system, the existing money ratio continued to exist. When circumstances changed that ratio—the new ratio became as sticky, if not more. Gradually the defacto ratio was given legal sanction and fullfledged bimetallism came into operation. After several centuries of its operation in Europe, America adopted this double standard in 1792 and kept it in operation up to the end of the 3rd quarter of the 19th century. Like continental Europe, England also had bimetallism upto 1816 in which year it adopted gold monometallism and in that, only gold had free coinage and unlimited legal tender character and silver was reduced to the position of subsidiary money with limited legal tender character and was also deprived of free coinage for the public. Any way, England enjoyed the advantage of bimetallism all the same because it had a fixed foreign exchangerate with the bimetallic currency. In Europe bimetallism continued right up to 1873. But the most important point to be emphasised in this connection is the existence of bimetallism and not where and in how

many countries. Bimetallism maintained the relative values of gold and silver to the ratios chosen all over the world during this whole period. The standard of value during this period all over the world was gold and silver considered as a homogeneous mass. India also did not form any exception to that general rule and had a full-fledged bimetallism.

Akbar, the Great Moghul, introduced gold mohur and silver rupee, each having the same weight of 175 grains troy. Both the coins were the common measure of value, though they circulated without any fixed ratio between them. But international bimetallic ratio between gold and silver was perforce enforced on the Indian currency system which was bimetallism pure and simple. But this absence of an official fixed ratio between gold mohurs and silver rupee led Jevons<sup>1</sup> to an erroneous conclusion that Indian system was a parallel-standard and not bimetallism. As Mohurs and rupees were both common measures of value, market condition could not but establish a relation between them, things equal to the same thing, being equal to each other. Again, inspite of the absence of legal ratio between mohurs and rupees, each of them bore a fixed ratio to "dam," the copper coin of the Moghuls and as such the two circulated at a fixed ratio. This legal fact at least should have desisted Jevons from such a misleading conclusion.

The Great Moghuls even, did not succeed to establish their full suzerainty in Southern India and the princes of Southern India, as the symbol of their

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1 (Money and Mechanism of exchange, 1890, P. 95).

independence, minted and circulated their own coins. They minted gold coin mainly and it was commonly known as "pagoda." The Southern India virtually had no silver coins circulating with unlimited legal tender character. But inspite of the absence of silver coins, there was no difficulty of exchange between Northern and Southern India and gold and silver assumed as a homogeneous mass was the standard of value for the whole of India.

The Moghul Emperors exercised the right of coinage with a full sense of responsibility. They never debased their currency. When the Moghul Empire broke up and on its ruins arose a large number of independent principalities, the currency situation became anomalous. The Moghuls considered the right of coinage as the most unmistakable sign of sovereignty and exactly for this reason, political adventurers also took up this as the first step in declaring their independence. These new sovereignty-hunting princes wanted to have, each a separate coin of his own. With innumerable new princes in the different parts of the country, various coins of gold and silver with different weights and fineness, came in circulation. Country was flooded with myriads of coins. These new coins not only bore the names of new kings, but also were different from Moghul coins in weight and fineness. In most of the cases these were most wantonly debased without always altering the denominations. But inspite of these multiplicity of currencies and their varied denominations, the standard of money, did not change but remained gold and silver considered as a homogeneous mass. Bimetallism is an

international standard, and is independent of national boundaries and diversity of coins. The only difficulty that was added by these multiplicity of coins was that the intrinsic value i.e., the genuine metallic content of each coin had to be determined in advance of its acceptance as prices of commodities. A definite class of indigeneous bankers grew up who specialised in the evaluation of the real worth of different coins and they were known as shroffs. Once these bankers ascertained the value of a particular coin, it circulated freely. This multiplicity of coins made the vision of Dr. Ambedkar very hazy and blurred and he jumped to the conclusion that trade was reduced to barter. Far from it. Bimetallism was not unseated from its saddle and there was no fundamental change in the currency standard of India.

When the East India Company became the rulers of the country, they found as many as 994 different coins made of gold and silver and of varying weight and fineness, in circulation. The company found its commercial transactions hampered, but certainly not to the extent apprehended by Dr. Ambedkar, by this chaotic condition of the currency and set upon to bring uniformity of currency in place of diversity. Within their territory they suppressed all other coins but their own. Next they tried to establish a legal ratio between their gold coins and silver coins. But unfortunately in all the three Presidencies, into which Company-occupied territories were divided for purposes of administration, this attempt to establish a legal ratio, was more or less a failure.

In 1766, the Government of Bengal began to coin gold mohurs and silver rupees at a ratio of 16.45 to 1 while the market ratio was 14.81 to 1. This serious undervaluation of silver brought Gresham's Law in full operation and it was being drained away not only to China but also to Bombay and Madras where ratio was much more favourable to silver. When Bengal was going to be deprived of its entire supply of silver money, the Government in 1769 issued a bigger gold mohur at a lower legal ratio of 14.81 to 1. At this time market ratio in India was 14 to 1 and in Europe 14.61 to 1 and as such the new legal ratio also seriously undervalued silver. They could not succeed to maintain silver coins in the currency which was filled up with gold coins only. Being seriously confounded by these two successive failures Government stopped coinage of gold in 1788. Though they resumed coinage of gold again in 1790, they did not establish a legal ratio between gold and silver coins but allowed them to find out their own ratio. The Government tried in 1793 to establish a ratio of 14.81 to 1 but only to be baffled because this ratio also differed from the market ratio. The Government of Madras also made similar attempts to establish a legal ratio between gold and silver but failed more ignominiously. The Government of Bombay seemed to be more well-informed about the dangers of bimetallism and their attempts, though not so disastrous were not completely successful.

These failures of the three Governments in establishing a legal ratio was clearly due to a lack of understanding of the mechanism of bimetallism. It is

not possible for two administrative units to maintain bimetallism at two ratios and there was no one ratio at the same time in their ratio experiments of the three Presidencies. Again, their ratios were different from European ratio. The Presidencies were not financially more important than Europe and it was too much to expect that they could maintain any ratio different from that of Europe. The best way for India was the Moghul method of free coinage of gold and silver and to leave the ratio between them to be determined by European bimetallic system. Only if the Company tried to learn this lesson, they would be spared of many of their future troubles.

Being exasperated by these failures and under the influence of English monometallism, the Directors of the Company asked the Presidencies in 1806 to adopt silver monometallism and to have a uniform rupee, weighing 180 grs. and containing 165 grs. of pure silver. The task of making the units of currency uniform everywhere was first undertaken by Madras. They suppressed in 1818 both gold and silver coins and introduced the coins of same fineness and weight as desired by the Court of Directors. In 1824 Bombay followed Madras by introducing gold rupee and silver rupee of the same weight and fineness as in Madras. The situation in Bengal was a bit complex. It had three different types of silver rupees to be reduced to one and to be made uniform with the rupees of other provinces. It had already suppressed Benares type of rupees in 1819 and in 1833 made the Furrakkabad rupee, the same as Madras and Bombay rupee. Only the remaining sikka rupee was to be

eliminated and the mohur of Bengal was to be brought in line with the gold rupees of other Presidencies. These two in Bengal and demonitization of gold would completely fulfill the instructions of the Court. But all the three Governments of India were very much unwilling to demonetize gold and they did not carry out the instructions of the Court of Directors on this point. Thus the only effect of this uniformity movement was a simple Double Standard of gold and silver with one type of coin of each metal.

A Central Government for all the Company's possessions was established by an Act of Parliament in 1833 and this necessitated one system of currency for the whole of India. It required a common currency in place of mere uniform currency. The Central Government passed an Act in 1835, by which gold was summarily demonetized and a common silver rupee was to be coined and circulated for the country as a whole. Mints were opened to the free coinage of silver. Though the Act deprived the gold coins of their legal tender character, yet it authorised the coinage of gold mohurs and five, ten and thirty rupee gold coin at market value, if required by the public.

Passing of this Act led to a great stringency in the money market. Dr. Ambedkar advances several reasons to explain this monetary stringency. Firstly he maintains,—“Just about this time great changes were taking place in the economy of the Indian people. Such a one was a change from kind economy to money economy. Secondly, about this time an enormous increase of trade took place. Thirdly, a large proportion of silver rupees were being abstracted from circu-

lation and being put to non-monetary uses\*\*" While the mint was coining on the one hand, people were melting those coins on the other and converting them into bangles and other ornaments. "Fourthly there were no credit media to speak of to relieve the monetary stringency and banking was yet in an undeveloped condition\*" While admitting the strength of all the arguments put forward by Dr. Ambedkar in explaining this monetary stringency, we must say that he failed to realize that the most important cause lay in the Act of 1833 itself which demonetized gold and all gold coins suddenly ceased to circulate as money. This sudden withdrawal of one half of money-supply while demand for money was increasing, could not but create a serious monetary stringency. That, demonetization of gold was effective, at least for the time being, was apparent from the fact that though gold coinage was not stopped, no gold was brought to the Mint for coinage. This situation necessitated a revaluation of silver in relation to commodities, i.e., bringing down price-level to something like one-half of its former level. The way out of such a painful revaluation was to increase rupee supply at a very rapid rate. But it was very difficult to procure additional quantities of silver from Europe. Mercantilism lingered on in Europe which was rather unwilling to part with their previous metal for India. At least it was out of the question to procure such a huge quantity of silver to fill up the void created by demonetization of gold. Dr. Ambedkar opines,— "that in so far as India was saved the trials and tribulations undergone by the

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\*Dr. Ambedkar: The problem of the rupee: Chapt. I.

bimetallic countries to preserve the silver part of their currency, the abrogation of bimetallism was by no means a small advantage.\*" But this socalled advantage was at the expense of the country being deprived of one-half of its currency, while there was no way open to increase the other half promptly and thereby subjecting trade and industry of the country to a serious strain and leading to a very unjust and arbitrary redistribution of the national wealth. Moreover, the trials and tribulations of bimetallism for India was a needless nightmare to Dr. Ambedkar; because these were undertaken by Europe and America where bimetallism ruled upto 1873 and India would only derive the benefit of that system by simply not demonetizing gold.

Gradually, Indian public began to recover from this rude shock and took to gold money as well, in effecting their purchases. Government also felt the pinch of depression and was forced to issue a proclamation in 1841 permitting the acceptance of gold mohurs by the public treasuries at a ratio of 15: 1, the market rate at that time, in payment of Government taxes. This gave a great fillip to the re-introduction of gold money and bimetallism re-entered by the back door. There was de-jure silver monometallism but defacto bimetallism.

Californian gold mines were discovered in 1848 and Australian mines in 1849 and by 1850 these mines were in full productive activity. These made gold cheaper than official valuation at 1 to 15 and people began to pay their taxes, only in gold coins. This

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\*Dr. Ambedkar: The problem of the rupee: Chap. I. •

meant a loss to the Government, because gold coins were of lower intrinsic value. Government also could not force these coins on their creditors at the official rate because of their non-legal tender character. The Government was therefore forced in 1852 to suspend the acceptance of gold coins altogether in payment of public dues. But this time, the public was not taken by surprise. Withdrawal of the proclamation of 1841 made the monetary situation intolerably more stringent. Public could not help using raw gold also, for monetary purposes side by side with silver rupees at the market ratio. That gold circulated as money inspite of its being deprived of legal tender character, was pointed out to the Government by the Bombay Chamber of Commerce in 1863:—\* “that there is an increasing tendency to the creation of a gold ingot currency, by the natives of this country, as a rude remedy for the defects of the existing silver one.... that gold bars, stamped with the mark of Bombay banks, are for this purpose circulated in serval parts of the country.” This was simply one of the indications of the free use of gold as money.

Public did not sit idle in the meantime. There were repeated pressures on the Government to re-introduce gold in the currency officially and to recognise the back-door entry of gold. The Government had to yield again and by a notification in 1864 authorised the public treasuries to accept sovereigns and half-sovereigns at a rate of 10 rupees per pound in payment of public dues. Treasuries were also

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\*Report of the Bombay Chamber of Commerce, 1863-64, App. I, p. 206, as quoted by Ambedkar.

authorised to make their payments in sovereigns and half-sovereigns, whenever they had a supply of those and provided people were willing to accept those in payment. In 1866 the Government appointed the Mansfield Commission to report on the desirability of re-introduction of gold coins. The Commission gave their verdict in favour of introducing gold currency and recommended the issue of gold coins valuing 15, 10 and 5 rupees. But unfortunately Government remained absolutely silent on the report of the Commission and public could never know whether Government accepted or rejected the report of that Commission. Government issued a notification in 1868 raising the rupee-value of sovereigns and half sovereigns from Rs. 10 and Rs. 5 to Rs. 10-8 and Rs. 5-4, to bring the ratio between rupees and sovereigns to conformity with market ratio of gold and silver. This notification was partially successful and gold began to pour in. This was the situation upto 1873.

Thus we find that the Act of 1833 was virtually a dead letter, because it could not demonetize gold in practice. Several factors worked against this demonetization. Firstly, the non-stoppage of the coinage of gold had something to do. Secondly, general acceptability of gold coins and gold bars in purchase and sale by the Indian public in spite of the Act of 1833, went a good deal to defeat the purpose of that Act. Thirdly, the Government action to accept gold coins in discharge of public dues completed the nullification of the demonetization clause of the enactment. Fourthly, prevalence of a full-fledged Double Standard in Europe and America during this period,

keeping the relative values of gold and silver fixed, kept the whole world on bimetallism wherever gold and silver were used as money. Bimetallism was the monetary system of India, inspite of the Act of 1833, right upto 1873. Gold and silver, considered as a homogeneous mass was the standard of value in India during the whole of this period. The English rulers simply mattered with the currency and did not or could not fundamentally alter the system. Looked from this distance of time we find that the diversity of coins after the breakdown of the Moghul Empire and the uniformity of coins brought about by the English, were both unimportant incidents in the currency history of India. These were the incidents relating to coinage as such and had practically very little to do with the system of Indian currency and the standard of Indian value.

## CHAPTER II

### THE PERIOD OF Silver Standard (1873-1893)

What the Act of 1833 could not effect, was effected by some events in early seventies of the last century. Silver standard was suddenly thrashed upon India and the Act of 1833, subsequently replaced by the Act of 1870, became at once operative. In 1873, Germany not only demonetized silver but also deprived silver coins of their unlimited legal tender character, melted down all the silver coins and sold them for bullion. In 1874, Sweden, Denmark and Norway suspended free coinage of silver. The countries of the Latin Union did the same in 1877. In 1873, America also closed her mint to the free coinage of silver. Bimetallism was universally suppressed.

The wave of demonetization of silver originated from a uniformity-movement for weights, measures and coinage. The Great London Exhibition of 1851 brought into prominence the difficulty of comparing different exhibits owing to the diversity of standards of measures, weights and coins of different countries of the world. The different scientific assemblies gathered on the occasion of this Exhibition stressed on the necessity of making weights, coinage and measures uniform all over the world. The view was

unheld in the Brussels International Statistical Congress in 1853 and in the next Statistical Congress at Paris. The Vienna Statistical Congress of 1859 supported these in much stronger terms. Berlin Statistical Congress of 1863 decided to invite all the prominent Governments of the world to send delegates to a special Congress to be convened for a single decimal system of currency for all the countries of the world. But if the conference concentrated their attention only for the uniformity of coinage all over the world, it would not have meant any change in the bimetallic standard of the world. But another incident raised the question of standard also with the question of the reform of minting. France had a bimetallic currency and her system with the same legal ratio between gold and silver was accepted by all the countries of the Latin Union. By taking advantage of the uniformity movement, France wanted to extend the boundary of the Latin Union over the world, i.e. to have her currency system accepted by all the countries. French Government approached the British Government with this proposal, but the British Government maintained that she could not consider the proposal unless the other party introduced gold monometallism which England had introduced in 1816. France at that time was very much anxious to placate England, because she was very much apprehensive of the rising power of Prussia. She accepted the British proposal and in the Conference which was held in Paris in 1867, France in co-operation with the other Latin Union Countries persuaded the Conference to resolve that for a uniform interna-

tional coinage it is essential that gold should be the principal currency and silver should simply form subsidiary coins. The Conference was so much engrossed with the idea of uniformity of coinage, that they did not and probably could not realize that the enforcement of their resolution meant the sacrifice of bimetallism.

The Conference was followed by the Franco-Prussian War from which Prussia emerged victorious and managed to form German Empire with the Prussian king as the Emperor of Germany. The newly formed Empire probably thought it beneath its dignity to have any other metal but gold in her currency. In 1873, she not only demonetized silver but also melted down a huge quantity of silver coins and sold them for bullion. The movement for demonetizing silver once set on foot, was at once followed by other North European Countries bordering Germany. The Latin Union and America also followed in quick succession. But in the Latin Union Countries, specially in France and in America, though further coinage of silver money was stopped, yet the silver coins minted up to date and in circulation were allowed to be in circulation with unlimited legal tender character. With the fall in the price of raw silver, there arose a difference between the price of silver coins and silver. The face value of the coins became higher than their bullion value. Whatever was the value of gold coins was also the value of silver coins. Owing to the retention of free coinage of gold, value of gold coins and gold bullion was the same and the value of the silver coins, so to say, limped behind the value of gold. From this

characteristic, the monetary system of France and U. S. A. assumed the title of Limping Standard. The mechanism of limping standard needs therefore be explained.

To explain the mechanism of limping standard, we should call the attention of the reader to the two essential conditions of bimetallism: (1) Unlimited legal tender character of both silver and gold monies at the legal ratio and (2) Free minting of both gold and silver for the public at that ratio. To bring about limping standard in place of bimetallism, further free minting of one of the metals, say silver, is to be suspended and nothing more is to be done. Thus, under limping standard also, unlimited legal tender character of both gold and silver monies at the legal ratio remains as in bimetallism. Silver coins that have been already minted and are in circulation, are allowed to be in circulation. They are not called back. If the supply of raw silver increases and its price falls, in terms of gold, below the legal valuation of silver coins, yet this newly mined cheaper raw silver cannot be minted any more into coins and drive gold out of circulation. The price of raw silver though lower than coined silver has got to remain lower and may become lower still. Silver coins become permanently dissociated from silver bullion. This is the same thing as saying that silver in coined form becomes more valuable than in uncoined form. Silver coins become overvalued token coins—their face value becoming higher than their intrinsic value. Whatever is the value of gold coins becomes also the value of silver coins. This

high value of silver coins is not maintained by convertibility of these in terms of gold and as a matter of fact silver coins are inconveritble in terms of gold. Their value is maintained at this high level, simply because their number is limited and is not sufficient to drive all the gold coins out of circulation. As gold coins are needed to fill up a part of the circulating medium and as they can be kept there only at their metallic value, silver coins also have got to attain that value. Raw gold retains its link with gold coins because it retains free minting and it can be melted also. If the supply of raw gold increases from the mines and its value comes down, it will lower the value of gold coins, because more gold coins will be minted. But when the value of gold coins falls lower, the concurrently circulating silver coins also falls in value, for if it does not fall, people will take to their rival, gold coins. The competition of the gold coins will keep the value of silver coins equal to it. If the value of gold becomes so low that it falls below the value of the metallic content of the silver coin, the latter will be melted down by the operation of Gresham's Law and the currency will be filled up with gold coins only. But in any case the value of each unit of circulating medium will be completely determined by the value of gold. In the reverse case, if the value of gold rises up, some of the gold coins will be melted down and the value of both silver and gold coins will be higher, due to the diminution of the total supply of money and by this process the value of each unit of money will be determined by the value of gold. Thus it is clear that limping standard, inspite of its silver coins, is a type

of gold standard and the standard of value is gold pure and simple.

This system has been named limping standard, because the value of the silver part of its currency limps behind the value of gold. If the essence of the system, i.e. the value of the silver part of its currency depending on its limitation of quantity, is appreciated, it is not very difficult to understand that the currency authority may increase the number of silver coins without any detriment to the system. As long as the number of silver coins does not become greater than the total of gold and silver coins existing before this increase of silver coins, parity of value of silver coins with gold, will be maintained. Thus the existence of gold coins is not essential to the maintenance of limping standard. What is wanted is the ideal regulation of the quantity of silver coins.

Silver part of the limping standard proves another fundamental point of monetary theory that a unit of currency need not have any intrinsic value. Silver coins in a limping standard attains a value higher than their intrinsic value. What is the harm if these silver coins are replaced by, say, paper money? There will be absolutely no difference. As long as there is legal tender character and limitation of quantity, its value will be equal to the gold coins. Even if the entire currency is filled up with paper money, there will be no deviation from its gold value, provided regulation of its supply is ideal.

But this regulation of the supply of over-valued silver coins or paper money is rather a

difficult thing. If increased or decreased demand for money changes the value of such money unit, its gold value can be restored by increasing or decreasing the total quantity of money. This increase or decrease of total quantity of money is effected by foreign exchange mechanism in a system of gold exchange standard, which is a type of limping standard from which all gold coins have been displaced by overvalued silver or paper money.

To resume the historical narrative again: the movement for demonetization of silver, which brought about pure gold standard in some countries and this peculiar limping standard in others, was further accentuated by a high output of silver from newly discovered mines and the introduction of improved processes in all the mines. But the increased supply of silver in the 4th quarter of the 19th century was not out of proportion greater than the increase of gold in the 3rd quarter of that century. And yet their relative value during the first period was well-nigh constant at the ratio of 1 to  $15\frac{1}{2}$ , while in the third quarter, value of gold fluctuated between 16.10 and 26.75 weights of silver per one weight of gold. The explanation is not far to seek. During the first period, bimetallism was in operation and the relative values of gold and silver were kept at a fixed ratio by the compensatory action of bimetallism. During, the second period bimetallism was not only abrogated by suspension of coinage of silver, but also some countries like Germany drove silver completely out of

currency. If this abrogation did not take place, abundance of silver could not have lowered its price, because of the compensatory action of bimetallism. But this abundance of silver made the already bad position worse. Once Germany set the ball rolling by demonetizing silver, a huge supply of silver was thrown in the bullion market, bringing a great pressure on the bimetallic countries for coinage of silver. The extra supply from mines made the pressure on the bimetallic countries greater still. When some more countries demonetized silver, the situation became intolerable and the sheer fear of summary flight of gold led the bimetallic countries to the suspension of silver coinage. New supply from mines began to stagnate in the bullion market, bringing about a catastrophic fall of silver price.

Germany and some other countries of Germanic culture drove out silver from their currency altogether and adopted gold currency pure and simple. Silver coins that remained in currency in the limping standard countries, became disconnected from the value of silver and their value began to limp behind that of gold. Whatever became the value of gold was the value not only of gold coins but also of silver coins. In other words, not only in gold currency countries but also in limping standard countries gold became the standard of value while under bimetallic system, gold and silver considered as a homogeneous mass, was the standard of value. Thus the suspension of silver coinage meant a fundamental change in the currency system of the world. It changed the standard of value altogether.

In limping standard countries, silver coins simply economised the use of gold. But the facts of suspension of free coinage of silver and the higher level of value of silver coins in comparison with their metallic content, prove that economy in the use of gold by silver coins was of lesser dimension than would have been the case under bimetallism. On the other hand demonetizing of silver in Germany and her followers, created a serious void in the currencies to be filled up by gold only. This necessitated a sudden revaluation of gold in the gold standard countries, in other words, necessitated a sudden and serious lowering of the prices of commodities. Though England had an effective gold currency and gold standard from the beginning of the 19th century, she also felt the pinch of gold scarcity. She had to surrender a part of her gold supply to other gold hunting countries. Of course, a certain amount of gold was released from the Far Eastern countries like India, East Indies and China, which were forced down to silver monometallism after the break down of bimetallism. But the void created by demonetization of silver was out of proportion greater than the gold released from the East. All the gold standard countries had therefore to face a painful lowering of commodity prices and business slump.

That shrinking of currency leads to a lowering of price and business depression at an accelerated rate, is too patent a fact to need detailed analysis. Capitalistic economy is profit economy. When the prices of things are falling, the businessmen as buffers, feel

the first pinch of it, i.e. they suffer losses. These losses force them to curtail their scale of production and throw many out of employment. The unemployed, being deprived of their income, cannot purchase their consumables, at least on their previous scale, the price of which begins to fall, creating further unemployment. Thus we find that shrinkage of money lowered prices, lowered prices created unemployment, unemployment further lowered prices and the whole process proceeded on in a vicious circle subjecting Europe and America to the worst slump in their history. It is really very strange to find economic historians to pay scant attention to this all important cause of the economic depression of the 4th quarter of the 19th century. In vain do we look for this analysis in Dr. Knowles "Industrial and Commercial Revolutions of the 19th century." Nor do we find a proper emphasis on the monetary cause of the industrial and business boom in England from 1850 to 1873. England was firmly saddled, from the beginning of the 19th century, on monometallic gold standard. An excessive supply of gold production during this period, raised the price level in England and gave a very great fillip to its industrial boom for which other factors also were favourable. Of course bimetallism in Europe and America did not allow a considerable fall in the value of gold, but there was some fall in the value of gold and England, being specially in a favourable position, utilised it to her advantage and strengthened her industrial and commercial supremacy. Other countries also shared in this general prosperity. India

was specially unlucky during this period (1850-73), because her gold demonetization Act of 1833 was fighting hard to suppress bimetallism and India could not enjoy any rise of price of gold-using countries.

But the table turned after 1873. Owing to the shortage of supply of silver it was not possible to fill up the void in the Indian currency created by demonetization of gold and the Act of 1833 became a dead letter. Gold had to be recalled and put to the service of currency. But after 1873 when silver began to pour in from mines on the one hand and Europe and America on the other, all the gold coins in India mysteriously disappeared. Supply of silver, now, was not only sufficient to fill up the void of gold but was many times greater than that. The Act of 1833, subsequently replaced by the Act of 1870, to introduce silver monometallism became effective—and effective with vengeance. Quantity of money began to increase by leaps and bounds, and prices of commodities were rising higher and higher. Enterprisers were earning a good dividend and there was a great productive and commercial boom in India. The last quarter of the 19th century may be said to be the golden period of Indian economic history.

Compared with the trade and industry of a gold standard country like England, trade and industry in India were in a very flourishing state. The gold standard countries suffered the worst slump in their history during the period of falling value of silver. All the Western European countries and America had to suffer considerably but England, which during the

third quarter of the 19th century was the workshop of the world, was the worst sufferer. There was a progressive decline of per capita industrial productivity of England and every industry had to share this general decline. Unemployment was rampant and began to mount up to colossal figures. The textile, iron, coal, hardware, sugar refining, earthen ware, glass, leather, paper and sundry other industries were all affected by this serious depression and were offering fewer and fewer employments. Though agricultural production was on the average level, still agriculturists were reduced to penury by the fall of price of agricultural goods. But in India trade and industry during this period were thriving at a great stride. Manufacturing development of this period was most pronounced and phenomenal.

Of the industries, cotton and jute manufactures were most markedly developed. Of the most ancient and renowned industries of India, cotton fabric was one. Dacca muslins and Murshidabad silk were known to far off lands. But partly by the disturbances that followed the break up of the Moghul Empire and partly by the Industrial Revolution in England, Indian cotton industry was paralysed. The period of rising prices was taken advantage of, to re-introduce the industry on capitalistic basis. Success was immediate and rapid. The industry began to progress by leaps and bounds and that inspite of obnoxious and depressing cotton excise duty. The phenomenal development of the industry will be apparent from the following table:—

\*The development of Indian Cotton Trade and Industry:

	Growth of Trade (Average Annual Quantities in each Quinquennium)				
	1870-71 to 1874-75	1875-76 to 1879-80	1880-81 to 1884-85	1885-86 to 1889-90	1890-91 to 1894-95
Imports of raw cotton thousands of cwts ... ...	23	52	51	74	89
Exports of raw cotton thousands of cwts ... ...	5236	3988	5477	5330	4660
Imports of twist and yarn ... ...	33.55	33.55	44.34	49.09	44.79
Growth of Industry at the end of each fifth-year					
Number of mills ...	48	58	81	114	143
Number of Spindles, 000 omitted	1000	1471	2037	2935	3712
Number of looms, 00 omitted	10	13	16	22	34
Number of persons employed ...	—	39537	61836	99224	—

The development of jute industry also was equally phenomenal. Jute industry was not an old industry like cotton. The depression in the Dundee jute industry forced some Scottish industrialists to start some jute industries on the banks of Hugly. At once the industry struck its roots deep in the soil. English, rather Scottish capital, business management, expert skill and machines began to be imported en-masse and

\*Ambedkar: The problem of the rupee p. 102.

Calcutta became a greater jute manufacturing centre than Dundee. During the whole of this period, jute industry every year was stronger than it was in the previous. The following table shows its continued growth:—

\*Development of Jute Industry and Trade.

Growth of Trade.	Average Annual of each Quinquennium				
	1870-71 to 1874-75	1875-7 to 1879-8	1880-81 to 1884-85	1885-86 to 1889-90	1890-91 to 1894-95
<b>Exports—</b>					
Raw, million cwt	5.72	5.58	7.81	9.31	10.54
Gunny bags, millions.	6.44	35.96	60.32	79.98	120.74
Cloth, million yds.	—	4.71	6.44	19.79	54.20
<b>Growth of Industry</b>					
Number of mills	—	21	21	24	28
Looms,000 omitted	—	5.5	5.5	7	8.3
Spindles, 000 omitted	—	88	88	138.4	172.4
Persons employed, in thousands	—	38.8	38.8	52.7	64.3

Development of Indian agriculture also was equally phenomenal. Upto the middle of the 19th century, Indian farmer was virtually self-sufficient—producing and consuming his own products. But after 1850, Industrial Revolution in England and Railway development in India, brought this country to the vortex of the world economic order. Crops were not

\*Ambedkar: The Problem of the Rupee p. 103.

raised with an eye to his own consumption but with the eye to the world price of the commodity. He produced for the world market and bought from the world market. Increase in the exports of agricultural commodities is a fair indication of the improvement of his position during this period. The following table will show this conclusively:—

\*Growth of Agricultural exports of India.

	1868-69	1873-74	1877-78	1882-83	1887-88	1891-92
Wheat	100	637.41	2313.47	5152.36	4914.37	11001.44
Opium	100	118.38	123.83	122.47	120.20	116.82
Seeds	100	111.26	305.87	239.97	403.60	480.99
Rice	100	131.66	119.84	203.28	185.55	220.36
Indigo	100	116.91	121.57	142.17	140.76	126.33
Tea	100	169.35	293.17	507.25	775.09	1075.75
Coffee	100	86.04	69.98	85.31	64.59	74.11

Against these advantages, there is a debit account. Though the falling value of rupee supplied a stimulus to the employer by giving him more profit yet this was at the expense of the employees because their wages were not rising sufficiently rapidly to make good their loss from rising prices. Therefore it was robbing Paul to pay Peter and India did not gain by it on the balance. The strength of this argument cannot be denied. When prices rise, wages also rise but lag behind prices and consequently wage earners suffer. But there is another side of this picture. In cotton and jute industries alone an additional number of about one lac of

\* Ambedkar: The problem of the Rupee p. 104.

persons got employment and it was not effected by starving agriculture of its normal supply of labour. Agriculture also enjoyed a boom and employed more persons. The cotton and jute industries only provided employment to one lac of unemployed persons. Assuming 4 dependents on each workers, 5 lacs of persons were provided for in these industries. These 5 lacs of persons, before employment were on starvation point and their demand for consumption commodities was very meagre. After employment they demanded a much greater amount of consumables, to produce which another batch of the unemployed got their employment and so on. In other words, the primary employment of 5 lacs of persons necessitated a secondary employment of many lacs of persons to provide the consumables of the previous batches. Employment in cotton and jute industry more than doubled. Previous number of employees suffered a diminution of real wage but many times than that number had then been earning a good wage in place of no wage. Wage earning class, as a whole, earned much more than before and the rise of prices was beneficial to wage earners also. This beneficial effect has been simply due to the fact that rise of prices increased the national dividend itself. All the industries, including agriculture, improved more or less. As the silver standard increased the national dividend of India, it was beneficial to the country on the whole.

As trade is the second stage of industry, trade of India, both internal and external, increased as phenomenally as industry. But as we have no satisfactory records of internal trade, we are to depend on external

trade statistics only for verification of this particular point. The period of rising prices saw a continuous and rapid growth of foreign trade of India. As will be apparent from the following table, the foreign trade of the country became double at the end of this period in comparison with the first years of silver standard.

\*Imports and Exports. (Both merchandise and Treasure).

Year.	Exports. R.	Imports. R.
1870—71	57,556,951	39,913,942
1871—72	64,685,376	43,665,663
1872—73	56,548,842	36,431,210
1873—74	56,910,081	39,612,362
1874—75	57,984,549	44,363,160
1875—76	60,291,731	44,192,378
1876—77	65,043,789	48,876,751
1877—78	67,433,324	58,819,644
1878—79	64,919,741	44,857,343
1879—80	69,247,511	52,821,398
1880—81	76,021,043	62,104,984
1881—82	83,068,198	60,436,155
1882—83	84,527,182	65,548,868
1883—84	89,186,397	68,157,311
1884—85	85,225,922	69,591,269
1885—86	84,989,502	71,133,666
1886—87	90,190,633	72,830,670
1887—88	92,148,279	78,830,468
1888—89	98,833,879	83,285,427
1889—90	105,366,720	86,656,990
1890—91	102,350,526	93,909,856
1891—92	111,460,278	84,155,045

There is every reason to suppose that internal trade also increased at the same rate.

\*Dr. Ambedkar: The problem of the Rupee p. 99 as quoted from Appendix II to the Report of the Indian Currency Committee of 1898.

There are something particular to be said about the external trade of India. All the other silver standard countries experienced a rise in the price of commodities. Such was the case with all Far-Eastern countries like China, East Indies etc. These countries were therefore excellent markets for Indian commodities and as good as Indian markets for Indian commodities. So far as gold countries were concerned, the situation was a bit different. As the foreign exchange rate between two countries is an expression of the ratio of the price-levels of the countries, Indian exchanges with the gold countries began to fall with the fall in the value of silver. This fall of Indian exchange was pointed out to be the cause which discouraged English exports and encouraged Indian exports. From theoretical point of view this contention is absolutely untenable. Before 1873 Indian exchange was, say, Rs. 15 to the pound or Re. 1 to 1s. 4d. This exchange after 1873 was falling from 16d. to 15d. 14d. 13d. 12d. etc. These falling exchanges were the result of rising prices in India. The Englishmen pay a price for rupees, because these have purchasing power on Indian commodities which the Englishmen require. As the price of these things in terms of rupees rise, the Englishmen are willing to pay less pence for the rupee. Thus the Englishmen are not tempted more than before to purchase things from India. If they are not tempted to a greater extent to buy from India, how can the Indian exports get bounty from falling exchanges? Similarly by selling

English goods in India for rupees, English exporters lose, because each rupee is now worth less than before. While this is true, it should be remembered that English goods are sold at a higher price in India and the disadvantage of exchange is cancelled. Hence falling exchanges neither encourage Indian exports nor can discourage English exports. It should be a matter of indifference to both the parties.

But there is another point to be considered. When the price-level of a particular country is falling and is expected to fall further, the foreigners in anticipation of that further fall, quote a price for that country's money, not equivalent to its purchasing power at that moment but equivalent to a somewhat lower purchasing power expected to be in the near future. In other words, the external value of an inflating currency falls faster than its internal value. This additional fall in the external value of the currency works as an export bounty to an inflating country. This was the case with India on silver standard, when the price of silver was falling. In the case of a deflationary currency, its foreign value rises faster than its internal value and this acts as a penalty to her export trade. This was the case with England and other gold countries, with the rising price of gold at that time. In conclusion we find that not only silver countries with rising prices of things provided an excellent market to Indian products, but gold countries also provided a still better market. Thus, from the standpoint of national divi-

dend, industry and trade, India was in an ideally prosperous condition.

It is sometimes maintained that India did not derive any great advantage from the increase of her exports to gold countries, because the terms of trade turned against her owing to an additional fall in the gold value of the silver currency and consequently due to a very high price of commodities from gold countries. But this is a very wrong view of the situation. Once it was profitable to export more, it became simultaneously profitable to import more. International trade is purely barter. Rate of profit might have become lower but profit there was and this was proved from the existence of trade itself. Again, once India got purchasing power in England, she was not bound to spend that in England only. She might and did divert some of such purchasing power to silver countries and thereby spared herself of the high prices of gold countries. Anyway, the worst that can be said is that it was a larger trade at a lower rate of profit and this is a sound business maxim.

Again, some maintained that fluctuating exchanges during this period discouraged Indian foreign trade very much. This erroneous statement is not even worth any rejoinder. Indian exchange was steadily falling in relation to gold countries only. It should not have been confused with fluctuating exchange. Steadily falling exchange stimulated foreign trade with gold countries specially and that has been explained already. So far as silver countries were concerned,

question of fluctuating foreign exchange did not arise at all.

A word needs be said about foreign capital in India during this period. Bombay school of Economics, including Dr. Ambedkar, maintains that falling exchanges acted as a great check to foreign capital in India, because value of rupee securities was constantly falling in terms of gold, which was the standard of our lending countries. Government adopted a policy of developing what was called "Extraordinary Public works" i.e., a system of transport, mainly Railways and network of irrigation, financed by capital borrowing from England. India Government was very much handicapped in borrowing money from England. Every sterling loan became a constantly increasing burden in terms of rupee and the Government dared not shoulder such a terribly growing burden. Hence the development of these extraordinary public works was seriously handicapped.

But there is the relieving feature in the rising price of the asset at the same time. To the extent that the external value of the rupee was falling to a greater extent than the internal, to that extent, the debt burden was increasing to a greater extent than the value of the asset. This meant a real extra burden and to that extent, benefit from the public work was reduced.

The import of capital on private account also was on the same basis. The value of the assets in which foreign capital was invested, was rising but to the extent external value was falling to a greater degree, to that extent rise was not sufficient to offset fall of foreign exchanges. But there was another considera-

tion. For this very rising prices and falling exchanges, Indian industries were more profitable than English industries and investments. This was more than sufficient to offset the disinclination of the foreign capital to come to India, due to an extra fall in the foreign valuation of the rupee. This is proved by a huge flow of foreign capital on private account during this period. The jute and tea industry developed phenomenally during this period with foreign capital and foreign enterprise exclusively. In many other industries also and specially in mining, foreign capital flowed in freely. Thus the fear on the account of discouragement of capital in India was on the whole groundless.

The fall of exchanges created a very serious difficulty for the India Government, because of its obligation to make huge gold payments to England. Being based on silver, India had to offer an increasing price for procuring gold. Prior to 1870 this difficulty was absent. India could procure gold at a more or less fixed price. Before 1870 some countries had also purely gold currency and some had purely silver currency. But there was no difficulty in international exchanges between gold countries on the one hand and silver countries on the other. As there was bimetallism in France and the Latin Union, in Europe and America in active operation, relative values of gold and silver currencies of the different countries of the world, were kept fixed by the compensatory action of bimetallism. Gold and silver considered as a homogeneous mass,

was the standard of value all over the world. Whether a particular country used gold or silver was not a matter of consideration at all and it made no difference to the situation. But with the break down of bimetallism by suspension of silver coinage in Europe and America, the world was sharply divided into two currency units, one having gold as the standard of value and the other silver. With the appreciation of the value of gold and depreciation of the value of silver after this breakdown, currencies of the silver countries could purchase lesser and lesser amounts of currencies of gold countries, in other words silver exchanges began to fall. The silver countries which had contracted gold obligations were in a peculiar difficulty. India for example, had to pay a huge amount annually, called Home Charges, in terms of English currency i.e., gold. But as the value of gold was rising in terms silver which formed Indian currency, the rupee burden of this obligation was increasing. The rupee burden of the India Government on this account increased from two directions. Not only value of silver was falling in terms of gold but also the amount of Home Charges i.e., gold obligations were on constant increase. India Government raised its revenues in terms of rupees and her resources became seriously crippled by this ever increasing burden. The budget estimates of the government were repeatedly upset by the fall of silver value. What was calculated by the Finance Member to-day was upset by the change in silver price tomorrow. What a terrible inroad this doubly increasing burden effected in the government resources, will be clear from the following table.

**\*Increase in the Rupee Cost of Gold Payments.**

Financial year.	Average rate of exchange for the year.	Total excess of rupees needed to provide for the net sterling payments of the year over those required to meet the Sterling Payments of 1874-75.	Amount of this excess due to	
			1 Fall in the rate of exchange over that of 1874-75.	2 Increase in gold payments over those of the year 1874-75
1875-76	1.9·626	86,97,980	41,13,723	45,84,257
1876-77	1.8·508	315,06,824	144,68,234	170,38,590
1877-78	1.8·791	130,05,481	114,58,670	115,46,811
1878-79	1.7·794	185,23,170	104,16,718	81,06,452
1879-80	1.7·961	39,23,570	165,37,394	126,13,824
1880-81	1.7·956	312,11,981	192,82,582	119,29,399
1881-82	1.7·895	318,19,685	198,76,786	119,42,899
1882-83	1.7·525	62,50,518	186,35,246	248,85,764
1883-84	1.7·536	344,16,685	233,46,040	110,70,645
1884-85	1.7·308	196,25,981	248,03,423	51,77,442
1885-86	1.6·254	182,11,346	254,95,337	437,06,683
1886-87	1.5·441	409,16,788	446,68,299	22,48,489
1887-88	1.4·898	463,13,161	496,60,537	33,47,376
1888-89	1.4·379	900,38,166	659,71,998	240,66,168
1889-90	1.4·566	775,96,889	606,98,370	168,98,519
1890-91	1.6·090	906,11,857	465,48,302	440,63,555
1891-92	1.4·733	1044,44,529	654,52,999	389,91,530

Due to this ever increasing burden, Government had to levy more and more taxes every year. It had also to curtail other expenditures as far as practicable. During these difficult years, Government adopted the method of recruiting Indians to fill up higher posts, because these officers could be paid a lower salary and

\*Ambedkar: The Problem of the Rupee p. 89 as compiled from figures in Appendix II, p. 270 of the Indian Currency Committee of 1893.

that in terms of rupees. Inspite of all attempts to increase revenues and decrease expenditures, Government budget was always at a deficit during the whole of this period. The difficulty of the Government in contracting sterling loans for beneficial public work activities in India, has been already explained. This difficulty evolved out of the mortal fear of the Government in increasing gold obligations. Total excess of rupees needed to provide for the net annual sterling payments over those required to meet the sterling obligations of 1874-75, increased from about 87 lacs of rupees in 1875-76 to over 10 crores in 1891-92.

But against this loss must be set the increase of national dividend many times greater than this sum. Owing to the increase of national dividend, taxable capacity of the Indians increased and their power to bear a burden of taxation became much greater than what they could bear before. Government was embarrassed because it had to levy more and more taxes every year and taxation is always an unwelcome thing. Growth of manufactures, development of agriculture and employment of millions of unemployed were immeasurable benefits from rise of prices before which Government losses in exchanges were incomparably insignificant.

Persons whose incomes were fixed in terms of rupees, were the worst sufferers from rising prices. European civil servants were specially hit hard, because they had to make some home remittances to their relatives every month. They were recompensed by the Government through statutory fixed exchange

rates and the loss of the Government on this score has been already accounted for.

Rising prices reduced the debt burdens of the debtors. This meant a considerable relief to the poor agriculturists and petty artisans and from the stand-point of distribution it has every thing to commend.

On the whole, silver standard, conferred the greatest boon on the country and the period from 1873 to 1893 may be said to be the golden period of Indian economic history. Therefore the attempt of the Government to suppress silver standard and to introduce gold standard was condemnable in the strongest possible language. It is really a great pity that leading Indian economists—(Bombay School of Economics) like Jather and Beri considered the Government's desire to end all this uncertainty by switching the currency on to gold to be a move in the right direction; and Dr. Ambedkar considered the stabilization of exchanges to be more important to India than to England.

## CHAPTER III

### The Period of Arbitrary Standard ( From 1893 to 1898 )

The silver standard of 1873-93, in spite of its brilliant record, had the misfortune of creating many enemies. The industrial and commercial interests of England, specially Lancashire and Dundee, waged a ceaseless war against it. They wanted stability of exchange either by acceptance of a gold currency by India or by suspension of free coinage of silver. The advantage they were to derive from such fixity of exchange was obvious. Lancashire, one of the most influential financial organizations and a very powerful voting unit, first of all directed its energies to prohibit any customs duties on its piece goods exports to India. But the success of this attempt did not arrest the decline of Lancashire trade, nor did it in any appreciable degree, impede the continued growth of Bombay industry. Secondly Lancashire succeeded to have excise duty imposed on Indian piece goods production but that too did not change the situation. Lastly it concentrated its entire energy on the suspension of silver standard.

The economists of England were at loggerheads with these industrial and commercial interests. They maintained that rising and falling exchanges could not make any change in export or import trade of a country. In his evidence before "Gold and Silver

Commission" professor Marshall enunciated, what subsequently came to be known as, purchasing power parity theory of exchange and ridiculed the idea that the depression of English industries could be due to the depreciating silver standard of the East. His analogy was very pungent. "To suppose that a fall of exchange resulted in a loss to the former and a gain to the latter was to suppose that if a man was in a cabin of a ship only ten feet high, his head would be broken if the ship sank down 12 feet into a trough. The fallacy consisted in isolating the man from the ship when as a matter of fact, the same force, acting upon the ship and the passenger at one and the same time produced like movements in both. As the change in the exchange was itself a part of the more sweeping change in the general price levels of the two countries, the position of the English and Indian producer was equally good or equally bad."\* The only concession that the economists made was that the fluctuating exchanges introduced an element of uncertainty in the domain of foreign trade and on the whole acted as an increase of cost of transport. But this disadvantage pressed equally the East and the West and as such could not explain the depression of English industry and trade. In other words, there was collision between theoretical inferences and practical experiences. But the Lancashire school, in spite of its lack of logic, became more vocal and persistent and brought the Parliament also to its own views.

In India circumstances were more unfavourable to the continuance of the silver standard. Due to the

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\* Ambedkar: The Problem of the Rupee p. 108.

depreciating exchanges budget difficulties of India Government continued to increase at an accelerated rate. Theoretically considered, these were not difficulties at all, because taxable capacity of the people also increased, still the Government, specially because it was a foreign Government, dared not face the public every year with proposals of greater and greater burdens. Its difficulties were specially increased by Lancashire which did not allow any levying of duties on piece goods imports, the most important item of the imports, unless accompanied by cotton excise duty. Government was desperately looking for some way to stem the further fall of silver price.

Indian industrials cried in wilderness for the retention of silver standard. They could not supply any theoretical basis for their demand and they were political non-entities. There was none to represent rural masses. But the most deplorable thing in this connection was the indifference of Indian economists. Not even a single member of that fraternity spent a breath for silver standard. It is pardonable that they could not supply the theory of the benefits of a silver standard. But how could they be blind to the phenomenal development of trade and industry of India at that time under silver standard? Indian National Congress also did not raise a finger for it. Probably the subject was too difficult to be intelligible to that organization.

English investors, successful English businessmen in India wanting to transfer heavy sums to England and English Civil Servants of India, combined in the

movement for the suppression, of silver standard which had no body to support. It lost the case by default.

At first Government did not try to effect any change in the silver standard but tried to reintroduce some sort of bimetallism by international agreements. India Government sent delegates to the Monetary Conference of 1881 at Paris with the aim of supporting all proposals to re-connect silver with gold, i.e., to re-establish bimetallism. But that Conference could not reach any conclusion on that point.

But they hoped against hopes. In 1892, Indian representatives were sent again to the International Monetary Conference at Brussels which was convened to increase the use of silver in the currencies of different countries and if possible to reintroduce bimetallism. But the views of the different countries joining the conference were so very divergent that it was clearly foreseen that the Conference would fail to arrive at any decision. The Calcutta Chamber of Commerce foisted the failure and pressed the Government to introduce gold standard in case the International Conference failed to introduce bimetallism. This deputation of the Calcutta merchants has been a standing wonder to me. They were gaining by depreciating silver standard and inspite of that they wanted its suppression. Had not Calcutta jute interests any say in the matter? Was the Chamber controlled by Old businessmen with accumulated fortunes, eager to transfer their balances to England and retire from business? Anyway the ball was set rolling. "In their despatch of 23rd March, 1892, the Government of India, while urging the Secretary of State to lend his

support to any proposals that might be made by the United States of America or by any other country, for the settlement of the silver question by international agreement, called attention to the probability that failing an international agreement, the United States would be forced to stop the purchase and coinage of silver, and they requested the Imperial Government, in view of this contingency, to take forthwith into consideration whether any, and if so what measures could be adopted for the protection of Indian interests. On 21st June, 1892, the Government of India proceeded to record their deliberate opinion that, if it becomes evident that the International Conference is unlikely to arrive at a satisfactory conclusion, and if a direct agreement between India and United States is found to be unattainable, the Government of India should at once close its mints to the free coinage of silver and make arrangements for the introduction of a gold standard. In a telegram of 22nd January, 1893 the Government of India further explained the proposals as follows: 'Our proposal is that we shall take power to issue a notification declaring that English gold coins shall be legal tender in India at a rate of not less than  $13\frac{1}{2}$  rupees for one sovereign (i.e., 18d. per rupee). An interval of time, of which the length cannot be determined beforehand, should, we think, elapse between the mints being closed and any attempt being made to coin gold in India. The power to admit sovereigns as legal tender might be of use as a measure ad interim but it need not be put into force except in case of necessity.'\*\*

\*Report of the Indian Currency Committee 1898 para 11.

The Secretary of State, the Right Honourable the Earl of Kimberley, submitted the proposals of the Indian Government to a Departmental Committee for examination. Lord Herschell was the chairman of the Committee, other members being Mr. Leonard Courtney, Lord Farrer, Lord Welby, Sir Arthur Godley, Sir Richard Strachey and Mr. B. W. Currie. The Committee examined the working of the currency systems of almost all the leading countries of the world and came to the conclusion that to have gold standard it is not essential to have gold currency. As a matter of fact, most of the countries of the world maintaining substantial parity of their currency with gold had practically no gold in circulation. Again, while the Committee was in session, Brussels Conference ended in a fiasco and as such the Committee had no hesitation in upholding the India Government's proposals and submitted on 31st May, 1893 their report with the following recommendations:—

“While conscious of the gravity of the suggestions we cannot, in view of the serious evils with which the Government of India may at any time be confronted if matters are left as they are, advise your Lordship to overrule the proposals for the closing of the mints and the adoption of gold standard, which that Government with their responsibility and deep interest in the success of the measures suggested, have submitted to you.

But we consider that the following modifications of these proposals are advisable. The closing of the mints against the free coinage of silver should be accompanied by an announcement that though closed

to the public, they will be used by Government for the coinage of rupees in exchange for gold at a ratio to be then fixed, say 1s. 4d. per rupee; and that at the Government treasuries gold will be received in satisfaction of public dues at the same ratio."\*

The report of the Committee was accepted in its entirety by the English and Indian Governments and the Act No. VIII of 1893 was passed. This Act amended both the Indian Coinage Act of 1870 and the Indian Paper Currency Act of 1882. It empowered the Government to suspend further free coinage of silver for the public but was allowed to reserve the power of India Government to mint rupees on their own account. Indian mint was also to be closed to the free minting of gold. The Act was supplemented by three administrative notifications. The first notification put the Government under obligation to supply rupees in exchange of gold coin and bullion presented at the rate of 1s. 4d. to the rupee. The second notification empowered the people to pay their public dues if they so desired in sovereigns and half sovereigns at the rate of 16d. per rupee. The third notification put the Government under obligation to issue notes from Paper Currency Office in exchange of the gold coins and bullions. The purpose of the first and second notification was to supply rupees and notes in exchange of gold to any extent desired by the public at the rate of 16d. per rupee. In other words, maximum gold value of the rupee was fixed up at this level. But there was no provision to guarantee a minimum gold value of rupee. It was expected that the suspension of

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\*Indian Currency Committee 1893.

further coinage of rupees, while demand for rupees was increasing due to the increase of Indian industry and trade, will gradually push up its value to 16d. But till then, the guaranteeing of minimum value was supposed to be very risky. The measures of 1893 were clearly provisional with the ultimate aim of establishing gold standard.

This closing down of the mints led to an appreciation of the value of rupee and its value at once became higher than its intrinsic value. The gulf between the face value and intrinsic value of rupee began to widen with the lapse of every year. This will be clear from the following statement:—

Year	Metallic value of rupee	Average exchange value
1894	11 $\frac{1}{2}$ d	13 $\frac{1}{2}$ d
1895	11 $\frac{3}{4}$ d	13 $\frac{3}{4}$ d
1896	11 $\frac{7}{8}$ d	14 $\frac{1}{2}$ d
1897	10 $\frac{1}{2}$ d	15 $\frac{1}{4}$ d
1898	10 $\frac{3}{8}$ d	15 $\frac{7}{8}$ d

Thus the suspension of silver coinage meant instantaneous suspension of silver standard. Again, for all these years, gold was not the standard of value in India inspite of the gold clauses of the notifications. This is also clear from the above statement because gold value of the rupee was on a constant increase. The value of rupee was being determined according to quantity theory of money i.e., by demand for money in relation to the total quantity of it available. Thus it will be observed that gold could not be legal tender

money of the country during this period. Only rupee had this legal tender characteristic but it had no fixity of value in terms of gold. Simply a maximum gold value of rupee was assured by the power of the public to pay their dues to Government in gold at the maximum gold value of the rupee. But as the current gold-value of the rupee was much lower, nobody took advantage of that notification. In other words the standard of India, if it could have any name, should be named Arbitrary Standard, according to the nomenclature of Robertson.

The stock of coined silver i.e., rupees in 1893 when mint was closed to further coinage of rupees, was so very great as to be able to meet the growing demands for several years. In place of rising, the sterling value of rupee fell for some time even after the closure of the mints. This was caused by the redundancy of rupees but this redundancy disappeared soon and the shortage of rupee supply began to be increasingly felt. By 1898 money supply became so very scarce that the rate of discount rose up to 16 per cent. and contained to be high for 1899 also. Prices of things began to fall and the profits of the business community were converted into losses. High rate of discount made further investment of capital absolutely futile. The commercial community cried very hoarse against this famishing of money market and the Government was forced to come to the release of the situation. Act II of 1898 was passed to permit currency notes to be issued against gold with the Secretary of State. The notification of 1893 also authorised the issue of notes against gold but ~~that~~ gold

was to be in India. The remittance of gold from London to India took about 4 weeks and in the meantime the possessor of gold was without any currency in India. To remove this temporary difficulty, the Act of 1898 was passed and this authorised the India Government to issue notes on the hypothecation that gold with the Secretary of State was as good as gold with the Government in India. This Act did not go very far, and from its very nature could not go very far in relieving the stringency of the money market but it shows how very straitened was the condition of the money market which forced the Government to pass a law for such a minor relief.

The effect of this appreciating money unit on industry and trade was most disastrous. The following extract from "Review of the trade of India (1934-35) p. 176," will prove conclusively the stagnating nature of India's foreign trade.

Quinquennial Average	Imports	Exports	Total
1864-5 to 1868-9	31,70	5586	8756
1869-70 to 1873-4	3304	5625	8929
1874-5 to 1878-9	3836	6032	9868
1879-80 to 1883-4	5016	7908	12924
1884-5 to 1888-9	6151	8864	15015
1889-0 to 1893-4	7078	10499	17577
1894-5 to 1898-9	7367	10753	18120
1899-1900 to 1903-4	8468	12492	20960
1904-5 to 1908-9	11985	16544	28529

Before the period under review Indian foreign trade, both imports and exports were increasing by leaps and bounds but after the suspension of silver

coinage foreign trade was absolutely at a standstill. There was practically no rise at all. Trade with China, Japan and East Indies suffered specially. Trade with gold standard countries also suffered a setback. With the dwindling of foreign trade, export industries were subjected to a serious strain. Slump in export industries infected the domestic industries as well. Again, the domestic industries, based on the expectation of a continued rise of prices, when suddenly were faced with a stagnant or declining price, were shattered in many cases. Depression became general in all the industries.

Upto 1895, Indian exchanges continued to fall, in spite of the suspension of silver coinage, due to excessive coinage of silver in 1892-93. By 1895 exchanges touched the bottom, stood stationary for a moment and then began an upward jump. From 1893-95, Indian exports were enjoying the previous stimulus to gold standard countries at a diminishing rate but exports were at an increasing disadvantage in silver standard markets since 1893. But from 1896, value of rupee began to appreciate in terms of gold and Indian exports to gold standard markets also suffered a serious setback. The table now turned. The advantages that India enjoyed under silver standard from 1873 to 1893 were all converted into positive disadvantages. In one sense, condition of India during this period was worse than condition of England during the previous period. Though English exports were suffering in silver standard market during the previous period still they were not under any disadvantage in other gold standard markets. But

the condition of India was pitiable. Its entire external market was seriously crippled.

The depression in the export industries began to expand its wings and became cumulative. When a large number of persons became unemployed in these industries, it robbed another batch, which was producing its consumables, of its employment and so on in an unlimited series. Curtailment of Indian agricultural exports played havoc amongst rural masses. Indian agriculturists are always on starvation point and work with very small margin of income. When agriculturists, specially those engaged in export crops, had the market of their crops seriously delimited, they were reduced to penury. They brought misery to other agriculturists producing their food supply which they could not buy because they were not successful to dispose of their own products. The result was two successive and very widespread famines in 1896-97 and 1899-1900 which affected various parts of India and specially Bombay, Madras and Central Provinces. In 1867, the Special Commission defined famine as a condition under which large classes of population suffer from hunger but the definition has undergone a radical change due to two subsequent developments. Firstly the development of means of communication, specially the railways, has made food famine an impossibility because the scarcity of one locality can be easily made good from the abundance of another locality. Again, it is very rare that scarcity overtakes the whole of India at a time. Secondly the machinery organized by the Government to relieve famines has been highly perfected so as to

muster together all the beneficent forces. There are nowadays no such thing as food famines. There can be only money famines which means a temporary dislocation of employment on a wide scale due to failure of crops or non-saleability of products. Similarly famine relief also nowadays means provision of employments for the unemployed—not permanently unemployed but only temporarily thrown out of work.

The old definition can cover the famines of 1873 and 1876 but by the end of the century the new definition became fully applicable. Again, famines of 1873 and 1876 were local affairs while the famines at the close of the 19th century were extremely wide spread and general. These caused unemployment on an hitherto undreamt of scale. The best standard for measuring national dividend is the volume of employment. National dividend may be, roughly but fairly accurately, supposed to be proportional to the volume of employment. By currency contraction a huge volume of unemployment was created and this reduced the national dividend to an appalling extent.

When the Government closed their mints to free coinage of silver they expected that a rise in exchange, will come about first by a fall in internal prices and then by a lower import and greater export causing a favourable balance of trade. But the rise of exchange did not take place in this scheduled manner. Indian prices simply stopped rising for about 5 years and as a matter of fact there was a sharp rise in 1898. Of course this special rise of prices in 1898 was an exceptional case and can be explained on the ground

of a serious shrinkage of national dividend during famine years. Between 1893 and 1900, exports in place of increasing, remained absolutely stationary, rather were slightly dwindling. But both prices and exports should be considered in relative terms. Stationary prices, where prices were expected to rise should be considered as lowering of prices and a stagnant volume of exports under unexpectedly non-increasing prices, should be assumed as an increase of export. There were other causes also. Firstly there was a redundant supply of coined silver in 1893 and secondly terms of trade were turning strongly in favour of India. This point will be explained in greater detail in the following chapter. There was also the third cause in the diminution of national dividend. Strictures of Indian Economists on the so called lack of vision of the Government should rather be deflected to them for their defective analysis of the situation.<sup>1</sup> There were some other causes for non-fall of prices. This sudden stoppage of increase of prices upset the calculations of the Indian industrialists and agriculturists and this initiated a depression in those businesses which were catering for local demands. But as exchanges were improving and were expected to improve, the foreigners in anticipation of that expected increase overvalued the Indian rupee and as such Indian commodities were costlier for them than they should have been. But for this, exports would have increased much more. Anyway, improvement of exchange was attended with unemployment, priva-

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<sup>1</sup> Bertrand Nogaro, *La Monnaie* p. 48-54 and V. G. Kale Vol. II p. 439 and Jather and Beri Vol. II p. 311.

tion, industrial decay and widespread famines. Undoubtedly this has been the darkest period of Indian economic history.

But there were some relieving features also. Government officers, specially English Civil Servants of India were making a gain, in place of loss, from rising exchanges. Government could borrow from England more easily. But how far foreign capital investment on private account was encouraged, cannot be definitely ascertained. On the one hand their investments in India became less profitable but on the other, retransfer of capital and profit back to their country became itself a profitable exchange. The greatest purpose, for which it was done, i.e., giving relief to Indian Exchequer, was fully served. The burden of Home Charges was decreasing in place of increasing. But the English commercial community in India were the worst sufferers. They became very vocal now. Calcutta Chamber of Commerce probably now repented for its stupid representation to the Government in 1892 for the suspension of the silver standard and introduction of gold standard. Mainly to satisfy this disgruntled community who cursed the Government for famishing the money market in this awful manner, the Government appointed what is known as the Fowler Committee to suggest remedies to the situation.

## CHAPTER IV

### **The Period of Gold Standard ( From 1899 to 1914 )**

We have seen in the previous chapter that the Government by closing the mint to the free coinage of silver created a great monetary stringency and due to the pressure of business communities it had to undertake measures to relieve this stringency. The India Government proposed to relieve the situation by allowing gold coins in the currency while keeping the mint closed to silver and with this end in view wanted to make sovereigns unlimited legal tender in India. In the opinion of the Government the experiment of closing the mints for silver had been highly satisfactory because the rupee had steadily rose up in exchange value i.e. in terms of gold. The opportunity seemed to have arisen to realize the ideal of the currency policy i.e. to link Indian system definitely to gold and simultaneously increase money supply by additions of gold coins to relieve monetary stringency. With this aim in view they wanted that a gold reserve should be built up with money borrowed in England so that the Government may undertake the remaining obligation to establish gold standard i.e. to offer gold in exchange of rupees in unlimited amounts. An amount of rupees was also to be withdrawn from circulation to push up the exchange rate to 1s. 4d. and the silver

obtained by melting those rupees should be sold off in terms of gold and credited to the gold reserve. But though the aim of the Government was to put gold into circulation it was not to be done before exchange had reached upto 1s. 4d. and gold was not also to be made legal tender till then. There was another method of currency expansion as well. Though Government closed the Mints to the free coinage of silver for the public they reserved the right to mint rupees on their own account. By taking advantage of this reservation Government could expand rupee supply to relieve the market's stringency. This was the scheme of Mr. Lindsay, who asked the Government to sell Council Drafts without limit at the maximum sterling value of  $16\frac{1}{2}$ d. to the rupee. These Council Bills were to be sold by the Secretary of State on the India Government to be cashed by coining rupees or printing notes as desired by the public. Mr. Lindsay emphasised further that his scheme did not involve the sacrifice of gold standard which the India Government wanted to have for India. He also suggested a long-period loan of £10 million to be raised in London and to be kept in London as a gold reserve. The Government was to undertake the obligation of supplying gold in exchange of rupees and notes to unlimited extent and such demands were to be met from the gold reserves thus formed and kept in London. With this aim in view India Government was to sell sterling drafts in Calcutta in exchange of rupees on the Secretary of State at the maximum rate of 1s.  $3\frac{3}{4}$ d. to the rupee in unlimited amounts. The rupees received in India were to be locked up in

rupee reserve. The Council Draft provision of 1893 guaranteed the maximum gold value of the rupee and sterling drafts or reverse councils were to guarantee the minimum gold value. Rupee was therefore to be definitely based on gold.

The sale of Council Drafts would mean accumulation of gold in the London gold reserve and the depletion of rupee reserves in India. If rupee reserves would show signs of complete exhaustion, silver was to be bought with gold from London reserves and shipped to India to be coined into rupees by the Indian mints. Secondly the sale of sterling drafts would mean increase of rupee reserve in India and depletion of gold reserve in London. If an excess number of rupees would accumulate, the surplus stock would be melted and sold for gold and credited to gold reserve. The substance of this system was not to allow gold in circulation but to be used only as reserves and to have the same gold standard. Once the ratio of the rupee came up to 1s. 4d. further rise of exchange was to be stopped by minting more rupees which were expected to give relief to the then monetary stringency. In essence both the proposals were the same, the only difference between them was in the methods to be adopted to attain gold standard and relieve monetary stringency. Carefully analysed Government proposal was gold standard with a substantial quantity of gold coins in circulation i.e. a limping system of gold standard that prevailed in France and Mr. Lindsay's scheme was gold standard without currency. It was

supposed to be more economic because the purpose of gold coins was served with the coins of cheaper material.

To decide the issue between gold standard with gold currency and gold standard without gold currency, the Secretary of State appointed a Departmental Committee with Sir Henry Fowler as chairman. The Committee upheld the proposal of the Government of India and made the following proposals for the establishment of a gold standard with gold currency. The following were the main recommendations of the Committee (a): Like the Australian branches of the Royal Mint there was to be free minting of sovereigns and half sovereigns in India. Further coinage of rupees was to be kept suspended even on Government account till the gold currency was found to exceed the limit of public demand for gold money. (b) By the time the report of the Committee was submitted, the exchange had touched 1s. 4d. per rupee and the Committee recommended its retention at that point because prices and wages were supposed to have had adjusted at that exchange rate. (c) The rupee was to circulate with unlimited legal tender character side by side with gold currency. (d) The existing obligation of the Government to sell Council Bills to unlimited extent and their encashment in rupees was to continue. To fulfil this obligation the Government was to retain the exclusive right of coining rupees. For the time being minting of rupees might not be necessary but if people demanded more rupees, arrangements for further coinage of rupees were to be taken into hand. The profit on the coinage of rupees

was to be formed into a separate reserve called Gold Standard Reserve. (e) The Government was to undertake the obligation of supplying gold, specially for export purposes when the balance of trade went against India. This gold was to come from the Gold Fund proposed by the Committee and also from circulation. The gold from circulation would be possible only when currency was saturated with gold coins and the Committee expected that this would be the result of the adoption of their proposal of limping standard.

Apparently the Fowler Committee accepted the India Government's proposal of Limping Standard and recommended free coinage of gold and unlimited legal tender character of both gold and silver coins with the suspension of silver coinage. But closely examined, the Lindsay scheme was also to be found lurking behind the suggestions. The Committee upheld the right of rupee coinage for the Government and if the Government were to exercise that power, rupee might be made the only currency in circulation. With the coinage of rupees, gold could not have entered into circulation as long as rupee remained generally acceptable and not very unpopular. The gold value of the rupee might in that case be maintained with the help of gold reserves to be formed from profits of rupee coinage and from paper currency reserves. If the verdict of the Committee was to be definitely in favour of limping standard, further coinage of rupees should have been recommended to be summarily stopped so that gold might enter into circulation. In one word, the Committee evaded to give verdict in favour of any of the rival schemes. The Government at first took the

recommendations of the Committee for a limping standard and tried to act accordingly.

The Government of India accepted the report of the Fowler Committee almost in its entirety and passed the Act of 1899 making sovereigns and half sovereigns unlimited legal tender for the whole of India at the rate of 1s. 4d. to the rupee or 15 rupees to the pound. From 1899, the Government began their attempts to put sovereigns and half sovereigns into active circulation. They instructed their post offices to pay money orders in gold sovereigns and Paper Currency offices to meet the demand for encashment of notes in gold coins unless these were refused by the public. The district treasuries and railways also were instructed to make payment in gold coins if people were not unwilling to accept these coins. These attempts to put gold into circulation continued for 1900 and 1901 and a respectable amount of gold coins amounting to £6,750,000, passed into public hands by March 31, 1901. But one half of the gold thus put into circulation came back to the Government coffers, being paid by the public in discharge of their Government dues. A considerable part of the remaining half was exported away and a substantial amount was believed to be in the hands of the bullion dealers. Even with these discouraging signs of the gold experiments some high Government officials considered these experiments not to be entire failures, but the Government found in these signs, the dislike of the Indians to have gold coins in circulation and considered these experiments to be complete failures. Against this inference of the Government two things must however be mentioned.

The experiments were not given a proper trial for a sufficient length of time and the time chosen for new experiments was very inopportune because of the famines prevailing at that time. In the meantime negotiations were being carried on to start a mint to coin sovereigns and half sovereigns but due to the hostility of the British Treasury these became abortive. India Government was cornered from both the sides: it was faced with the dislike of the Indian public to have gold in circulation and the disinclination of the British Treasury to allow a gold mint to be started in India. The Government was therefore forced to give up any further attempt to put gold into circulation and to bury with it the Limping Standard proposal of the Fowler Committee. The gold that accumulated in the reserves of India was shipped to England to be kept, with other gold reserves, earmarked in the Bank of England.

After attempts in faithful compliance to gold recommendations of the Fowler Committee and failure in those attempts, Government had to look for some other method of relieving the stringency of the money market. They had to take advantage of that part of the recommendation of the Fowler Committee which permitted the Government to coin rupees to satisfy public demand. Here there was a clear case of public demand for rupees in the then monetary stringency on the one hand and the refusal of the public to have gold in circulation on the other. The sale of Council Bills was begun and to meet those, rupee coinage was resumed. In other words, the Government had to fish out the Lindsay Scheme from the Fowler Committee's Re-

port. The truth of the flamboyant prophecy of Mr. Lindsay that the Government shall have to take his scheme inspite of themselves came out to be true. The sale of Council Bills was begun to an unlimited extent in 1900 and these were met from the rupee part of the Currency Reserve in India. After the resumption of the sale of Council Bills, there was a steady rate of rupee coinage upto the end of 1904. Silver bullion reserve was sufficient to meet this demand but in 1905 there was an abnormal demand for Council Bills and to meet those, the rupee reserve was nearly exhausted. The stock of silver bullion also ran short and the Government had to buy silver with a part of the gold reserves in London and shipped that to India. In the meantime rupee reserve in India sank down to danger point and the price of the Council Bills had to be allowed to rise to 1s. 4-5|32d. per rupee. But the silver bullion arrived soon and the mint worked overtime. Supply of rupees increased very rapidly and was not only sufficient to meet the demand but by the end of 1906 became much greater than what could be required for a very long time to come.

But the fact that the Government had to allow the exchange to rise above their maximum level injured their vanity. They went on coining rupees indefinitely so that under no imaginable circumstances they were in shortage of rupees again. For the whole of financial year 1906-1907 they continued their minting and due to the good harvest of India in that year, the demand for Council Bills was quite strong. By the end of October 1907, came the American Financial Crisis. America during and immediately after the crisis simply

sold to the outside world and bought practically nothing. The rest of the world was required to suffer unfavourable balance in relation to America. To safeguard the gold reserve of the Bank of England, her bank rate was raised first to 6 per cent and then to 7 per cent. This high rate in England virtually stopped short term lending to India by England with which Indian export trade was financed. The balance of trade turned strongly against India and the demand for Council Bills mysteriously disappeared. The Secretary of State to meet the Home Charges, could sell Council Bills of 30 lacs of rupees only by allowing the lowest exchange rate 1s. 3-29|32d. per rupee. Thereafter buyers could not be found even at that rate. He had to withdraw from the exchange market and met the Home Charges from the Gold Reserves. But his complete withdrawal also did not succeed to maintain the exchange which continued to fall and reached 1s. 3-11|16d. per rupee by November 25, 1907. This rate was lower than the lower specie point and this could not have occurred if rupee was a gold coin and as such the fall in the rate could not be greater than the cost of transporting gold. India Government had not a very large gold reserve and whatever they had they were surrendering in dribbles. But that could not help the exchange appreciably.

The gold reserve was in danger of insufficiency because it became incumbent to withdraw from circulation an immense volume of rupees to keep up the exchange and that meant increase of silver part of the reserve and diminution of the gold part. To save the

exchange rate, further and more drastic steps were essential. In December of 1907, the Government offered to sell Reserve Councils or Sterling Drafts, to an unlimited extent at the minimum rate of 1s. 3-29 $\frac{1}{2}$ d. per rupee on the Secretary of State who was to meet those from the Gold Reserves. There was a hectic demand for these sterling drafts and the total of these drafts amounted to £20 million within a year. The gold reserves of the Government fell from £31 million to £11 million within the space of one year. There was another invisible agent which worked in favour of the maintenance of exchange during this period. Railway and general loans to the aggregate amount of £14 $\frac{1}{2}$  million were contracted by India Government from London. To the extent of nearly £10 million money was spent in England to purchase material and this did not help the exchanges. But to the extent of nearly £5 million these loans were spent to purchase materials in India and these helped exchanges to the fullest extent. Hence the total assistance from reserves and loans amounted £25 millions. The total amount of rupees withdrawn from circulation was of this value i.e. £25 million. Indian harvest in 1908 was good and by the middle of 1908, the demand for Council Bills revived. Towards the end of the year 1909, the exchange fell again and the Reverse Councils were offered promptly. From that time to 1914 India had enjoyed good harvest and prosperity and the demand for Council Bills was a normal phenomenon and India built up a very sound gold reserve.

Out of the profits of rupee coinage, a separate gold reserve, called "Gold Standard Reserve" was

created and this together with Paper Currency Reserve kept the external value of rupees and notes.

The system of currency that gradually evolved through these trials and tribulations may be expressed as follows in the words of J. M. Keynes:

"(1) The rupee is unlimited legal tender and so far as the law provides, convertible.

(2) The sovereign is unlimited legal tender at £1 to 15 rupees, and is convertible at this rate, so long as a Notification issued in 1893 is not withdrawn i.e. the Government can be required to give 15 rupees in exchange for £1.

(3) As a matter of administrative practice, the Government is as a rule, willing to give sovereigns for rupees at this rate, but the practice is sometimes suspended and large quantities of gold cannot always be obtained in India by tendering rupees.

(4) As a matter of administrative practice the Government will sell in Calcutta, in return for rupees tendered there, bills payable in London in sterling at a rate not more unfavourable than 1s. 3-29|32d. per rupee."\*

Thus the second provision prevents the sterling value of the rupee from rising above 1s. 4d. by more than the cost of remitting sovereigns to India, and the fourth provision prevents it from falling below 1s. 4d. by more than cost of exporting gold. This means in practice that the extreme limits of variation of the sterling value of the rupee are 1s. 4-1|8d. and 1s. 3-29|32d. As sterling was during this period convertible into gold, to unlimited amounts and without

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\* Indian Currency and Finance, page 6.

question and gold could be exported freely from England, Indian system became gold standard pure and simple. The Government first wanted to introduce gold standard on the lines of French system but circumstances forced them to Mr. Lindsay's scheme of Exchange Standard. But method is not all-important. The gold standard was the real object to be attained and the exchange method introduced as sound a gold standard as might be introduced by the limping method of French type or even by the English method of gold monometallism. Anyway gold became the standard of value in India.

Exchange standard of India, as a type of gold standard, has been challenged on more occasions than one. The most serious challenge was advanced by Dr. Ambedkar in his "Problem of the Rupee" chapter seven. He considered rupee as a type of fiat money and thought the Indian system to be, what we signify in this book, an arbitrary standard. The volume of currency in India and therefore its value per unit depended on the whims of the Government which could increase or decrease it at will.

To prove his point, Dr. Ambedkar compared the rupee price-level of India with the price levels of England and America which were gold standard countries, during this period. He pointed out with convincing statistics that during the whole of this period, rupee price level in India rose much higher than the rise of gold prices in England and America. That during this period prices in India rose much higher than prices in other gold standard countries of the world is an incontrovertible fact. This was also the finding of the

Prices Enquiry Committee which investigated the course of prices for the period from 1890 to 1912. If rupee was as good as gold money, what was the cause of this discrepancy between foreign gold prices and rupee prices? Ambedkar submits the following explanation: "The actual exchange rate corresponds to the purchasing power parities of two currencies not with regard to all commodities but with regard to some only. The actual exchange rates are related to purchasing power parities of the two currencies with regard to such commodities only as are internationally traded. To assume that the actual exchange rate is an exact index of the purchasing power parity of the two currencies with regard to all the commodities is to suppose that the variations in the purchasing power of a currency over commodities which are traded and which are not traded are the same. There is certainly a tendency for movements in the price of these two classes of goods to influence one another in the long run; so that it becomes possible to say that the exchange value of a currency will be determined by its internal purchasing power."\* But the assumption that prices of traded and untraded goods move in sympathy cannot always be made, specially under Indian circumstances. Inspite of a large volume of exports and imports in the absolute sense, bulk of Indian commodities are produced and consumed locally. "They have only a very thin connection with foreign trade, gold and exchanges. Besides this thinness of connection which permits of deviations of the general purchasing power of a currency from the level indicated by the actual

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\* Ambedkar. The problem of the Rupee. Chapter VII.

exchange rate, it is to be noted that the price of Indian commodities which largely enter into international trade are not governed by local influences. Such exports of India as wheat, hides, rice and oil seeds are international commodities, not solely amenable to influences originating from changes that may be taking place in the prices of home commodities, and services. The combined effect of these two circumstances is to militate against the prices of traded and non-traded goods moving in quick sympathy. Although the maintenance of the exchange standard does imply a purchasing power parity of the rupee with gold, it is not a purchasing power parity of the two currencies with respect to all commodities but only internationally traded commodities. Thus the fact that the rupee maintained its gold value does not preclude the possibility of Indian prices being on the whole higher than gold prices."\* "Exchange standard tended to raise prices above gold prices by its peculiarity that it is capable of easy expansion but is not capable of easy contraction by reason of the fact that it is neither exportable nor melttable, nor it is convertible at will."\* But a gold currency is both expansible and contractible. "When export season is brisk, money has to be sent into the interior to purchase commodities. During the remaining six months of the slack season there is undoubtedly experienced a redundancy of rupee. If rupee were a gold coin, this redundancy could work itself off by three ways. The superfluous coins would come back to the banks and the Government, they would be ex-

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\* Ambedkar. The problem of the Rupee. Quotations are extracts from Chap. VII, pieced up together.

ported and would be melted down by people for purposes of consumption for other wants. But so far as rupee is concerned, you cannot export it without heavy loss, you cannot melt it without heavy loss and consequently the extra coins must return to the Government or banks or they must be absorbed by the people."\* In the latter case, price of internal things will rise specially because banking development was unsatisfactory and money could not return to banks and the Government easily and quickly. "Had gold formed a part of the Indian currency, (as in Limping Standard) it would have not only met the needs for expansion but would have permitted contraction of currency in a degree unknown to the rupee."\* As rupee behaves in a manner different from the manner of a gold currency, Exchange Standard cannot be said to be a gold standard.

The argument of Dr. Ambedkar is very subtle but its subtlety cannot for any length of time, save it from its inherent futility. Its futility may be laid bare in a moment. During slack season, redundancy of rupees develops. This redundancy could work itself off if rupee were a gold coin and could be melted without loss for other purposes. This shortcoming of rupee is however imaginary. Rupee, having a fixed exchange value in terms of sterling, has also a fixed value in terms of gold. The possessor of a rupee can always procure a fixed amount of gold buillion from bullion-dealers in exchange of a rupee and without any loss. The bullion dealers to satisfy many such demands will

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\* Ambedkar. The problem of the rupee. Quotations are extracts from Chap. VII, pieced up together.

order for more gold from outside. This additional purchase of gold from outside will minimise our favourable balance and thereby make smaller the demand for Council Bills. In other words, it will curtail the rupee supply in India to the extent of utilization of gold in industrial and ornamental purposes. Rupee, though a silver coin can effect no difference in the situation.

Secondly, silver character of the rupee cannot cause any difference in the exportability of our coins. Whenever the possessors of rupees want to export them, they can do it without any loss either by purchasing a reverse council or by buying gold from bullion-dealers. In both the cases, it would lead to contraction of Indian rupee supply. Gold rupee would not change the situation.

Thirdly, if due to lack of banking development rupees cannot promptly come back from the interior to the Government or banks, conversion of silver rupees into gold rupees will not expedite that return journey. Thus we find that the so-called redundancy attributed to silver character of the rupee would be there even if rupee were a gold coin. The difference in the exchange standard and gold standard therefore has no real basis but in the fantastic imagination of Dr. Ambedkar.

Nor should we overstate the case. Many think that gold exchange standard has been more economic than Limping Standard that was proposed to be introduced in India. This is not necessarily correct. To maintain external convertibility of rupee a huge gold reserve had been necessitated and to maintain internal

expansibility of notes and rupees a silver reserve was needed. But under Limping Standard, if currency was surcharged with gold coins to the maximum amount to which currency was contractible, that system also could be made as economic as Exchange Standard. Again the contention of Mr. Keynes that Exchange Standard is more easily contractible when necessary than Limping Standard and even gold currency standard, is undoubtedly an exaggeration. When exchanges turn against a gold currency country or Limping Standard country, gold will be exported and if it be difficult to collect gold suddenly, it will have a premium in terms of other units of currency system and in consequence will be rapidly collected, and go into the melting pot and out of the country. Contraction of currency will be as spontaneous as by reverse councils under Exchange Standard. This also shows that if under Limping Standard, currency was surcharged with gold to the maximum limit of contractibility, currency authority need not have kept any gold reserve at all. Thus we see that though the Government by force of circumstances, had to adopt Lindsay's scheme of Exchange Standard while it wanted to have Limping Standard, yet it adopted the same gold Standard under Exchange system as it would have adopted under Limping System.

A variant of this criticism of the Exchange Standard is that advanced by Jather and Beri. In their attempt to explain the very great rise as well as the special rise of Indian prices, during this period they maintain "that the inflation of currency was the main cause of the rise in prices. The rupee being no

more than a note printed on silver and being inconvertible into gold, it was almost as easy to issue it to excess as inconvertible paper notes. Its supply depended wholly on the discretion of the Government who had the monopoly of its issue. The Government often wrongly supposed that more rupees were necessary, when in fact they were not wanted and proceeded to coin them."\* In short they want to convey the idea that furious coinage of rupees during 1900-1907 was the cause of this specific rise of price from 1899 to 1914. But this amounts to saying that Government can increase the supply of rupees according to their sweet will and if this be true, Indian Standard cannot be gold standard. Jather and Beri should not have attacked Exchange Standard in this stealthy manner but should have attacked it in a frontal manner to draw public attention to this as Dr. Ambedkar has done. But this blackmailing cannot make exchange system devoid of its gold standard character.

There is no denying of the fact that the maintenance of 1s. 4d. value of the rupee depends on Government intervention and active manipulation. But once the value of rupee is determined, the total volume of money in circulation becomes independent of Government's decision. Of course Government have to supply rupees when sovereigns are offered or Council bills are presented but they cannot put additional rupees into circulation. If the Government mint rupees without any reference to the presentation

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\* Jather and Beri. Indian Economics. Vol. II, 4th Edition p. 421.

of Council Bills, those rupees will remain with the Government. There is another possibility. If the Government spend away a part of the rupee reserve for general purposes, which they do not, even then these rupees will come out of circulation. This additional supply of rupees will raise prices and in the long run will lower the exchange rate, necessitating the withdrawal of a part of the currency supply by the sale of Reverse Councils. Every Reverse Council means the locking up of so many rupees. The total volume of circulation therefore has no connection with the Government's likes or dislikes. The expansion of rupees is an automatic process like the expansion of any other gold standard currency. Again if the Government refused to meet the demands for rupees by offering Council Bills promptly, the only effect would be to push up the exchange rate. To maintain exchange rate they must satisfy the demand for rupees. If at any time rupees became redundant, their exchange value would fall, Reverse Councils would be offered and redundancy, wiped off. After the furious coinage of 1900-1907, when there was a great redundancy, rupees to the value of £25 million were withdrawn from circulation exactly as if so much gold was exported out of the country and rupees behaved just as gold coins would have behaved. Thus rise of prices both general and additional, in terms of gold would have taken place even if coinage of silver was disallowed or if rupees were gold coins pure and simple.

But the heartburning remains. What were the causes of additional rise of prices inspite of our system

being a gold standard? The causes are not to be found in monetary factors at all. In the detailed analysis of prices we find that taking the whole period 1890-1912, covered by the Prices Enquiry Committee, "there was a general rise in prices throughout India, which was specially marked after 1905. The rise in prices was specially marked in the case of hides and skins, food grains (pulses and cereals), building materials and oil seeds, all of which rose 40 per cent. or more above the level of the basic period. Cotton and jute rose about 33 and 31 per cent. respectively while other articles of food, metals and other raw and manufactured articles rose by about 25 per cent. There was a moderate increase in country sugar but on the other hand, there was an appreciable decrease in the prices of tea and coffee, imported sugar, dyeing and tanning materials, especially indigo, coal, shellac as also a slight fall in the prices of other materials."\* From this analysis it is clear that prices of raw materials and food stuffs increased much more than prices of manufactured articles, specially better kinds of these. During the period under consideration prices in terms of gold rose up all over the world. The combination of commodities in Europe and America, whose price rose less than the price of the Indian combination of commodities was differently composed. In European and American combinations manufactures predominated while in Indian combination, food stuffs and raw materials predominated. Prices of food stuffs and raw materials rose higher than manufacturing commodities in the world market and as such

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\* Jather and Beri. *Indian Economics* Vol. II, p. 416.

Indian prices could not but be higher than world prices. Comparison of prices of different combinations of commodities is illegitimate. The defective Index numbers which Messrs. Jather and Beri used should not have supplied the *raison-detre* for attacking the gold standard nature of Indian Exchange system. Indian products are mainly food stuffs and raw materials and India is not a manufacturing country in the sense of England where 75 per cent. of the population get their livelihood by being engaged in industrial and commercial pursuits. In India manufactures are ill developed and she imports bulk of her finished goods from abroad. But Indians are very poor and in their expenditures, finished goods figure a much modest position in comparison with a western European. As food stuffs and raw materials rose in prices in greater proportion than finished goods and as these constitute a greater proportion of an average Indian's consumption and production, Indian prices rose higher than western European and American prices. This is the same thing as saying that the terms of trade turned very much in favour of India. Indian exports are mainly raw materials and foodstuffs while her imports are finished goods. A relatively higher price level in India was an expression of the improved terms of trade for India.<sup>1</sup> Both the increased supply of rupees and rise of prices were caused by improved terms of trade and would have been the case under a purely gold currency. Increased supply of rupees was not and could not be an independent cause of the special rise of Indian prices. Rupee simply acted as

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<sup>1</sup> Vera Anstey. Economic development of India.

a faithful agent of the gold standard and was as good as a gold coin.

The India Government could not however realize that the non-descript currency system which they built up by groping like a blindman and more or less fortuitously, was a type of gold standard. They had been feeling ill at ease under this peculiar system. High officials of the Government felt and spoke on this system as if it was a temporary expedient and whenever the time became propitious, gold standard with gold currency would be introduced. In the country the agitation for a gold mint lingered on and in 1912 the India Government again approached the Secretary of State to do something in this connection. But in 1913, Keynes published his celebrated book, Indian Currency and Finance which brought about a complete change in Government's angle of vision on their currency system. The book proved to the satisfaction of the world that the Government unknowingly have given India, the best form of gold standard and the model to be followed by the rest of the world. In the same year, the Chamberlain Commission was appointed and the Commission under the influence of the analysis offered by Keynes as well as under his personal influence, (Keynes being one of the members of the Commission) gave the most unequivocal support and approval to the Exchange Standard and submitted a long list of recommendations to perfect the system. The commission maintained that gold currency was not an essential condition for a gold standard. It was positively disadvantageous to India to encourage gold currency for internal circulation,

specially on the ground of economy. The Commission favoured concentration of gold reserve in London because gold was required for foreign payments only. It specially emphasised on the Government definitely undertaking the obligation of selling Reserve Councils at the rate of 1s. 3-29 $\frac{1}{3}$ d. per rupee indefinitely and whenever required because on the prompt undertaking of this obligation depended the external value of the rupee.

The Government could not give any consideration to the various recommendations of the Commission as the Great War intervened but they were now convinced of the soundness of their currency system and were well contented with it. They were to look to the details when time became more propitious.

During the period under consideration prices in India were rising, more or less at a steady rate. The causes of the special rise of Indian prices have been already explained. During this period gold prices all over the world were also rising mainly due to the perfection of banking and economising of gold and India being based on gold was enjoying the benefit of rise of gold prices. The first impact of high prices was on the export commodities and gradually internal commodities were also influenced. Rise of prices increased the profit of entrepreneurs who enlarged their scale of production. Employment in rural areas increased, leading to the increase of national dividend. Industries also developed phenomenally. Cotton, jute metallurgical and mining industries were very prosperous. Every year they yielded more and more produce and offered more and more employments. In short

this was the period of continued progress in industries.

Trade being the projection of industry shared the same boom. A look at the following statement will show that a very high rate of increase in foreign trade was maintained during this whole period. While in the quinquennial 1894-95 to 1898-99 foreign trade did not increase at all and famines ravaged the country, during this period foreign trade showed a phenomenal growth, standard of living of the rural masses was increasing and internal trade was throbbing with activity.

	Quinquennial Average	Imports	Exports	Total
		lakhs of	lakhs of	lakhs of
		Rs.	Rs.	Rs.
1889-0 to 1893-94		70,78	104,99	175,77
1894-5 to 1898-99		73,67	107,53	181,20
1899-1900 to 1903-04		84,68	124,92	209,60
1904-5 to 1908-09		119,85	165,44	285,29
1909-10 to 1913-14		151,67	224,23	375,90

There was only one ominous incident during this period, I mean the famine of 1907-1908 in U. P. This synchronised with the American crisis of 1907 and a very serious contraction of Indian currency by the withdrawal of Secretary of State from selling Council Bills and the sale of a huge volume of Reverse Councils. We do not like to maintain that contraction of Indian currency was the sole cause of U. P. famines. If that were so, there would have been famines all over India. Anyway the intimate connection between falling prices and suffering on the one hand and rising prices and general prosperity on the

<sup>1</sup> As stated by Jather and Beri.

other cannot be argued away. Again and again we find that periods of falling prices are attended with suffering, privation, unemployment and dwindling trade and industry while periods of rising prices are also periods of general prosperity.

We can point out to many factors contributing to Indian economic prosperity during this period. Depression of the 4th quarter of the 19th century forced the European industrialists to modernise their systems of production and distribution. This rationalization of industry and trade lowered their cost of production and by the end of the 19th century they were freed from the disadvantages of falling gold prices. Their price structures were accommodated to their industry and trade partly by perfection of banking and partly by re-adjusting the range of incomes. By the last decade of the 19th century European manufacturers got rid of the depressing effects of deflation and in India they obtained a special advantage due to the suspension of coinage of silver. India's adoption of gold standard did not put them in any disadvantage. Expansion of railway system in India opened the entire Indian market. Perfection in the construction of seagoing vessels during the last quarter of the 19th century gave them an immense scope. They were deriving the advantages of large scale production and distribution to the fullest extent. Their selling more commodities in India also meant buying more from India; international trade being purely barter. Progress of agricultural commodities and raw materials being higher due to greater demand for them and due to economising of gold by perfecting banking mecha-

nism in the West, price level in India was on a constant increase. Rise of prices though caused by all these forces were effected through the instrumentality of a greater quantity of money. If it were not possible to increase money supply with expanding demand for it, the entrepreneurs would not have been stimulated to expand their scale of production, create more employments and national dividend. Thus, though increasing supply of money may not cause economic prosperity per excellence, still easy expandibility of money, with an expanding demand for it, is an essential condition of economic prosperity. This seems to be the inference of currency expansion and rise of prices of this period.

## CHAPTER V.

### The Second Period of Arbitrary Standard (1914-1925)

The outbreak of the War suddenly disorganised Indian trade and industry but once the first shock was over, the economic life moved on smoothly. The currency mechanism of the country also was not spared of the first shock. The exchange at once weakened. The Government met the situation by offering Reverse Councils and by a heavy sale of Reverse Councils amounting to £8 millions during the first six months of the War confidence in the currency was restored by February 1915 when a heavy demand for Council Bills reappeared and remained strong for the rest of the War-period so much so that the entire demand could not be met and exchange had to be allowed to rise. From the very beginning Government faced the situation with a bold front and saved the exchange creditably by offering to the commercial community huge amounts of sterling for foreign payments.

Though rupee exchange remained within the allowable limits of fluctuations at 1s. 4d. still India lost her gold standard from the very beginning of the Great War. London suspended free gold market on the outbreak of hostilities. Not only England but all the belligerents put embargo on gold exports and preserved their gold for War purposes. Now, gold standard means that the currency is convertible into a definite weight of gold and the gold should be disposable by the receiver in any manner he likes. If

the receiver cannot dispose of the gold thus received by converting his money, according to his will, there is no meaning in conversion. Indian rupees could be converted into sterling in London. The Government was under obligation to convert rupees into sterling to any extent. Sterling was convertible into a definite weight of gold and the gold received could be disposed of by the receiver for any purpose and to any place. Thus, though not directly, rupee was convertible into a definite weight of gold and as such rupee had gold as its standard. But when the British Government put an embargo on the export of gold save for Government's purposes and on Government's account, rupee's free convertibility into a definite weight of gold disappeared and it ceased to be on gold standard.

This point will become clearer if we look to the gold import statistics in India. The following table gives India's imports of gold during pre-War quinquennium and War period which shows a sudden disappearance of gold imports on the outbreak of the War:—

\*Net imports of gold into India on private account.

			£
1909-10	..	..	14,446,000
1910-11	..	..	15,986,000
1911-12	..	..	25,178,000
1912-13	..	..	25,052,000
1913-14	..	..	15,550,000
<hr/>			
		TOTAL £ ..	96,212,000

\* Compiled from statistics in Babington Smith Committee's Report, para 14.

			£
1914-15	..	..	5,637,000
1915-16	..	..	3,267,000
1916-17	..	..	2,797,000
1917-18	..	..	14,306,000
1918-19	..	..	15,000
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TOTAL £ ..			26,022,000

Thus we find that average gold imports of India during the War was one-fourth of pre-War years. Inspite of a very strong favourable balance of trade for India during War years her gold imports fell by only 22 per cent. of her normal absorption. This conclusively shows that gold was not procurable in exchange of rupees at a fixed rate.

Secondly the British Government authorised, rather required, the Bank of England to suspend gold payments for notes. Notes became inconvertible into gold and became virtually a fiat money. As rupee was connected to 1s. 4d. sterling and as in pre-War days these sterling notes were considered to be and really were identical with gold, rupee had gold as its standard. But when there was suspension of cash payments for sterling notes, rupee also became delinked from gold. Indian system became simply sterling exchange standard in place of gold exchange standard. Sterling became a fiat money but rupee was inseparably connected with it. One blind man was leading another. Indian monetary system was on an arbitrary standard.

Due to the suspension of gold standard in England a distinction between gold and pound sterling (notes) was established, pound sterling being depreciated in terms of gold. A visible sign of this depreciation was the sinking of dollar-sterling exchange rate below gold export point. Dollar was all-through on gold basis and such an unfavourable movement in exchange rate could not have taken place if sterling was based on gold. The par between dollar sterling before the War was £1: \$4.8666 but after the commencement of the War the exchange rapidly fell down to \$4.76 to the pound. It was essential to England to stem the tide of further fall because a smooth trading relation with America was a life and death question. Exchange was pegged at \$4.76 to the pound and it was kept there upto the end of the War. The pegging of the pound at a definite dollar value meant the offer of an unlimited amount of dollar at \$4.76 to the pound, to the public who wanted to have it in exchange of sterling. In other words English monetary system became dollar exchange standard at a lower dollar-value of sterling than the pre-War dollar sterling par. Dollar was the standard for sterling and as dollar was all throughout based on gold, sterling also was on gold basis.

But this confusing inference is based on the assumption that the system of pegging was identical with gold exchange mechanism. In the gold exchange mechanism, the redemption of the local currency in terms of a foreign gold-standard-money is accompanied with the contraction of local currency. Contrary

to this practice, though dollars were given for sterling at a fixed rate still the dollars received by the Government were not withdrawn from circulation but thrown back into circulation by being spent by the Government. In place of contracting the currency, Government issued a huge volume of treasury-notes with unlimited legal tender character. Money supply was immensely increased. Dollar sterling exchange rate was a very false indication of sterling's real value which was much lower than the pegged rate. When on the 20th March, 1920, pegging was withdrawn, dollar sterling rate fell rapidly to \$3.40 to the pound. This shows that the dollar value of the sterling was a fake and was artificially kept at a higher level than the real value of the sterling.

Peering behind the scene we find that this artificial dollar value of sterling was kept at a heavy cost to England. British capitalists owned a colossal amount of investments in America before the war. Titles to these were collected by the Government and were at their disposal at the very beginning of the War. Huge consignments of War materials were purchased by England from America to prosecute the War, while War at the same time crippled her export industries very seriously. An unfavourable balance of trade was created which could not be corrected by export of gold and contraction of currency. To liquidate this difference, English Government began selling English investments in America in greater amounts than unfavourable balance. Americans were very eager to purchase investments in their own country and sterling available to them could not be,

and was not allowed to be, by the English Government, as sufficient as desired by the American purchasers. Sterlings were at a great demand all-through and that is why it remained at an artificially high dollar value for the duration of pegging. When all the English investments were disposed of, the British Government contracted a heavy loan from America for the purpose. Thus by the end of the War, America, instead of being heavily indebted to England as in pre-War days became the creditor of England for a colossal amount. This analysis conclusively proves that dollar sterling exchange was a definitely false indication of the sterling's real worth which was much lower than that. Hence inspite of a fixed dollar exchange rate sterling was not based on gold. Rupee was therefore also not linked to gold.

Not to speak of having a fixed gold value, sterling suffered a continuous depreciation in its gold value. This will be clear if we look to the index numbers of prices of England and America given below:—

\*Index number of prices in India, England and U. S. A.

Year	India	U. K.	U. S. A.
1913	..	100	100
1914	100	100	98
1915	112	127	101
1916	128	160	127
1917	145	206	177
1918	178	226	194

\* Compiled from statistics on page 424, Indian Economics Part II, Jather & Beri.

Year	India	U. K.	U. S. A.
1919	196	242	206
1920	201	295	226
1921	178	182	147
1922	176	159	149
1923	172	159	154
1924	173	166	150
1925	159	159	159
1926	148	148	100*
1927	148	141	95
1928	145	140	97
1929	141	137	95
1930	116	120	86
1931	99	105.9	67.8
1932	91	102.8	64.5
1933	86	100.2	65.5
1934	88	104.1	75.5
1935	89	105	79

During War years prices were rising in every country. But rise of prices in England was much higher than in America. This shows that the value of sterling fell in terms of dollar i.e. in terms of gold. The extra rise of prices in England could not have been caused by terms of trade being turned in favour of England. Exchange had to be kept high virtually by an auction sale of English investments. It is common knowledge that auction sale cannot be at a favourable rate. Thus there is no way out but to

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\* New basis.

conclude that the special rise of prices in England was caused by inflation of English currency.

That the depreciation of the value of sterling took place mainly through inflation in England was a patent fact. The Government borrowed greater and greater amounts from the Bank of England as the War proceeded on. In ordinary times also Government borrow from the Bank but all these loans are cleared off within the financial year. During the War however, Bank's advances were not paid back and went on growing bigger and bigger and mounted up to huge amounts. These advances were spent by the Government on war materials and other war needs and the deposits of the Government were transferred on expenditure by the Government to other people's accounts. This meant an increase of other banks' deposits with the Bank of England. Other banks considered the deposits with the Bank of England as so much cash reserve which they were bound to keep against their deposit liability. Having their reserves thus swollen other banks increased their loans to the public several times as great as the amount borrowed by the Government. Thus the contracting of a loan by the Government led to the multiplication of bank money several times as great and the inflation of currency was magnified as many times.

But bank money is convertible into common money because people prefer to make a definite percentage of transactions in common money and for this purpose that percentage of cheque money is presented for

conversion. The banks know that an additional demand for common money is bound to occur from the making of additional loans. The other banks shunted off their responsibility of finding common money to the Bank of England by meeting demands on them with cheques on the Bank of England. Notes of the Bank of England depended, beyond a certain limit, on cent per cent gold and could not therefore be increased. Whatever gold there was, was blocked for Government purposes for the pegging of dollar sterling exchange. The bank was therefore forced to recall some of their advances to the Government to meet the situation. Government issued Treasury Notes, which had unlimited legal tender character in United Kingdom, and paid some of their debts with those. These treasury notes were not convertible into gold but simply fiat money. Thus the most important check on the issue of bank money was removed and the circulating medium in England went on increasing merrily. Government's borrowing from the public also mounted upto colossal amounts. These Government bonds were good collaterals in the eyes of the banks and there was no obstruction remaining to the unlimited expansion of money in England. This abnormal increase of money supply in England was the principal cause of abnormal rise of English prices and depreciation in the value of sterling.

Neutral countries also had to experience similar rise of prices and inflation of currency as the belligerent countries. To purchase war materials from

neutral countries, the belligerents seized the gold supply of their countries and suspended convertibility of their money into gold. The gold was shipped to neutral countries and there it became the basis of a huge superstructure of notes and bank money. Thus from 1914 to 1919 value of gold itself declined by one half. As gold went on diminishing in value, neutral gold standard countries as well as America, experienced similar inflation of currency.

Now, the Indian system before the war was a type of gold standard and the gold value of the rupee was maintained by sterling exchange mechanism. As sterling was convertible into gold, this meant effective gold standard. But after the commencement of the War and suspension of gold payments in England, India, true to her aim and purpose to maintain an effective gold standard, should have given up sterling exchange mechanism for, say, dollar exchange mechanism. Such a step might have maintained, if at all, gold standard in India. But several circumstances conspired to keep rupee wedded to sterling in spite of the latter's divorce from gold.

The Government of India have to make heavy sterling payments to meet Home Charges and the average annual amount paid during the pre-War quinquennial was £25 million. The ability of the Government to make this payment depended on favourable balance of Indian trade. During the pre-War quinquennial the following were the net exports of India.

\* Exports and imports of merchandise on private account.

Year	Exports	Imports	Next exports.
1909-10	125,253,000	78,040,000	47,213,000
1910-11	139,921,300	86,236,000	53,685,300
1911-12	151,896,100	92,383,200	59,512,900
1912-13	164,364,800	107,343,900	57,020,900
1913-14	165,919,200	122,165,300	43,753,900
-----	-----	-----	-----
Average for 5 years	149,470,900	97,233,700	52,237,200

\* The corresponding figures of the War years were as follows:

Year	Exports	Imports	Next exports.
1914-15	121,061,100	91,952,600	29,108,500
1915-16	131,586,800	87,560,200	44,026,600
1916-17	160,591,200	99,748,000	60,843,200
1917-18	161,700,000	100,280,000	61,420,000
1918-19	169,230,000	112,690,000	56,540,000
-----	-----	-----	-----
Average for 5 years	148,833,800	98,446,100	50,387,700

It will be seen that the pre-War average of the net exports was a bit higher than the War average and this is due to a great fall in exports during the first two years of War. If we take the average of the last three years of the War period, average works upto £59.6 million, much higher than the pre-War average. During the War, imports from central European countries were suspended and the Allies' productive organization was concentrated more and more on war needs. Hence Indian imports were seriously curtailed but exports from India were very keenly demanded. Inspite of transport and financial difficulties, raw materials and food stuffs were bought in greater and

\* Babington Smith Committee Report: para 12.

greater quantities by the Allies and the net exports were steadily increasing.

Again the Government of India were conducting War in the Eastern battle fields and as such were spending huge amounts to be recovered from the British Government. India Government spent on behalf of the British Government £240 million during the War and the amount was deposited in sterling with the Secretary of State or the British Government were on credit with him and this amount had to be issued in the form of rupees in India. The favourable balance and Government's war expenditure created a very heavy demand for Indian currency.

The situation was aggravated by the falling off of imports of gold for Indian consumption as we have seen before. If gold imports remained on their pre-War level, this might have minimised favourable balance to some extent and could have somewhat relieved the abnormal demand for rupees. It was not possible for our English and other foreign customers to offer gold for rupees and a demand for gold for the liquidation of our favourable balance would have paralysed Indian foreign trade. The only possible alternative would be to leave rupee seriously alone. But that would have forced rupee sterling exchange against England to an infinite height and England would have been made incapable to reimburse the military expenditure of the India Government on the account of England as well as to pay for the balance of Indian exports. To attain that, England would have to peg rupee sterling exchange also like dollar sterling exchange, by putting on an auction sale, all the English investments in India.

India in that case would have emerged from the War as a creditor country like America and not a debtor country. India lost the best imaginable opportunity to wipe off her foreign debts by the fateful decision of keeping her currency wedded to Paper Sterling.

Council Bills were offered by the Secretary of State on depositing sterling (paper) with him and these were encashed in rupees in India. Indian currency now experienced the same inflation as sterling and prices in India were soaring higher and higher. The real cause of War-time inflation in India was therefore the depreciation in her standard of value i.e. sterling which was an inflating paper currency. Indian system like English became an arbitrary standard.

But Indian inflation could not keep pace with English inflation. English currency consisted of simply paper and the increase of English money involved no cost. But Indian currency consisted of mainly silver rupees and a substantial quantity of notes. Notes again are convertible into rupees and for notes a rupee reserve is essential. Thus the increase of currency in India depends on availability of a sufficient quantity of silver to coin rupees for actual circulation and for reserve against note circulation. During the War, value of silver began to rise at a very rapid rate and the Government began to feel an increasing difficulty to procure more silver. There were several causes for this abnormal increase of value of silver. The first cause was a great shortage of supply. The world's production of white metal suffered an accelerated decline during War years as will be apparent from the following statistics.

## \*Mine Production of Silver (in fine ounces, 000 omitted)

Year	Canada	U. S. A.	Mexico.	Rest	Total of world
1910	32869	57599	71372	57249	219089
1911	32559	61109	79033	57683	230384
1912	31956	66041	74640	60423	233060
1913	31806	71200	70704	57966	231676
Average of 4 years	32297	63987	73937	58331	228552
1910-1913					
1914	28449	69634	27547	50418	176048
1915	26626	72369	39570	47180	185745
1916	25460	78875	22838	48283	175456
1917	22221	70666	31214	50949	175050
Average of 4 years	25689	72886	30292	49208	178075
1914-1917					

About three-fourth of the World's production of silver comes from Mexico, U. S. A. and Canada, Mexico being by far the most important producer. On account of political disturbances in Mexico silver production there was disorganised and mainly for this reason world production of silver fell from the pre-War average by an amount of 43.6 million ounces out of the average total of 50.5 million ounces of the world's total annual supply.

On the otherhand, world demand for silver, specially for coinage, became stronger and stronger. Coinage of silver in the British Empire only required 108 million fine ounces per year during the War while pre-War quinquennial average was 30.5 million fine

\* Report on the World's production of Silver by Profs. Carpenter and Cullis as summarised by Babington Smith Committee.

ounces. The other countries, specially belligerent countries also absorbed similarly big consignments of silver for coinage. This increased demand for silver-coinage was due to the conserving of gold by belligerents for War purposes by withdrawing it from circulation.

Again, United States of America constituted the principal silver market of the world and that country was based on gold. As gold lost half of its value between 1914 and 1919, gold value of silver became double only on this account. Sterling was depreciated in terms of gold and its pegged rate \$4.76 was lower than the pre-War parity \$4.86. Value of silver in terms of rupees therefore increased doubly.

The following list of silver prices shows successive upward jumps of the white metal from 1915 to 1920.

Price per ounce

1915	..	..	27 $\frac{1}{4}$ pence
1916	..	..	37 ..
1917 (August)	..	..	43 ..
1917 (September)		..	55 ..
1919 (May)	..	..	58 ..
1919 (December)	..	..	78 ..
1920 (February)	..	..	89 ..

Forty three pence per ounce is the silver-par of the rupee. At this value of silver, the intrinsic value of rupee becomes equal to its exchange value at 1s. 4d. and this par was attained in August 1917. The rise in the price of silver bullion in the rupee above its face value made the sale of Reverse Councils at 1s. 4d.

per rupee an impossibility because of the danger of rupees being melted down and sold for bullion. Hence the rate of exchange had to be allowed to rise *pari pasu* with the value of silver. The following table shows the successive upward jumps of the exchange rate.

Year	Exchange rate
1917 January ..	. 1s. 4 $\frac{1}{4}$ d.
1917 August ..	. 1s. 5d.
1918 April ..	. 1s. 6d.
1919 May ..	. 1s. 8d.
1919 August ..	. 1s. 10d.
1919 September ..	. 2s. 0d.
1919 November ..	. 2s. 2d.
1919 December ..	. 2s. 4d.
1920 January ..	. 2s. 6d.
1920 February ..	. 2s. 10 $\frac{1}{4}$ d.
1920 March ..	. 2s. 10d.
1920 April ..	. 2s. 8d.

By allowing these rises of exchange, rupees were kept in circulation and inflation of currency was of somewhat diminished dimension than in England. This raising of the rupee exchange is the real cause why during the War period, Indian prices rose in a less pronounced manner than the English prices. If rupee exchange could be kept at the original level, rise of prices in India would have been of same amplitude as the rise of prices in England.

Though exchanges were allowed to rise *pari pasu* with silver prices, yet Indian currency was not based on silver. There was no free coinage of silver, and there were always differences between bullion value

and face value of the rupee. Indian currency could not be completely a sterling exchange standard as well because of these changes of exchange rates.

The rise of exchanges were effected by controlling the supply of Council Bills. Supply of these bills offered for weekly sale was not of unlimited amount and was restricted to chosen buyers. The unsatisfied demand for rupees competed feverishly and raised up the exchange. In 1917-18 the import of gold in India rose upto £14 million in place of £2.7 million in the previous year and this was caused by the difficulty of obtaining rupee exchange when the sale of Council Bills were limited and controlled. This gold came mainly from U. S. A. and Japan who could not procure rupees to pay for their Indian purchases. Similarly we feel that if sterling-exchange standard were not accepted by India and the same difficulty were created for England to obtain rupee exchange, England would have to offer, in default of gold, her Indian investments to Indians. We therefore lost the chance of centuries to wipe off our foreign debts.

Let us now look to the effects of War-inflation on Indian economic life. Taking foreign trade first: On the outbreak of the War both imports and exports suffered very heavily. The exports recovered from 1916-17 onwards but the imports though recovered somewhat could not come to the pre-War level even towards the end of the War. There was however a very welcome sign in the change of the nature of exports from India. In 1913-14, 22.4 per cent of total Indian exports were manufactures while the foodstuffs and raw materials constituted the rest. In 1818-19

percentage of manufacturing exports rose up to 36.6 per cent of the total. The stimulus of rising War prices gave a great fillip to Indian industries like cotton, jute, leather, steel and iron and this accounts for the increase in the export of manufactures. We have seen in the last chapter that the years from 1900 to 1914 were a period of slow but sustained progress. The rise of prices during that period benefitted the cultivators generally because the prices of those articles which they exported rose much more than the prices of the imported articles they bought. Prices of jute, hides and skins, oilseeds and food grains rose by 43, 59, 45 and 42 per cent respectively while the prices of the imported cotton manufactures, metals, sugar, kerosene and salt rose by 25, 20 and 9, per cent and the last fell by 30 per cent respectively. But the reverse was the case during the War when prices of imports rose much higher than the prices of exports. This relatively unfavourable changes of prices are generally supposed to have adversely affected the Indian agriculturists. But this must be remembered that foreign imports constitute a very small part of an Indian agriculturist's consumption while he is much more influenced by the price of his saleable products. Rise of prices on the whole brought more money to him from his sales than he had to give away in higher prices for imports. Therefore Indian agriculturists on the whole gained from War-time rise of prices. Rural labourers suffered a diminution of wage but more of them got employment and the share of the national dividend that went to the labour class increased absolutely.

Manufacturers' profit was very much increased by the rise of prices during the War and immediately after the War. Profits have the inherent tendency to increase the scale of production and volume of employment and a very pronounced increase in the percentage of manufacturing exports is a positive indication of the consummation of those results. The tanning and leather industry was revolutionised under the stimulus of War prices. The rough tanned hides experienced the greatest development. This type of tanned hides is known as the East India tanned hides and is mainly produced in Bombay and Madras. In 1913, 194,763 cwts of tanned hides valued at Rs. 1.75 crores were exported while in 1917-18, 361,677 cwt valued at Rs. 4.86 crores were exported. In addition to this type, Indian tanneries increased the production of leather goods of all sorts and specially boots for the army in India and the Indian expeditionary forces in the Eastern theatres of War. The production of boots and shoes increased twenty times during the four years of War. The development of iron and steel industry was still more phenomenal. Before the War iron industries were practically non-existent in India, several small firms producing small quantities of pig iron. The Tata Company, though began operations in 1911, produced a very small quantity of iron and steel. By 1916 War demand supplied a great stimulus to iron and steel production. The Tata Company worked overtime and produced large quantities of sleepers and rails for the military railways of the Eastern theatres of the War. In 1917 a large extension of the plant of the Company was begun and it

was completed by 1924. The production of pig iron advanced from 162,282 tons in 1914 to 232,268 tons in 1919. From practically nothing, steel production became 139,433 tons in 1916-17. The War gave a considerable stimulus to many of the chemical industries where development was no less phenomenal than iron industry. The jute industry became stronger than ever. The number of mills and persons employed both increased. The pre-War quinquennial average of jute employees was 2 lacs while the War average was 2.6 lacs. Looms, spindles, authorised capital and production, increased at an accelerated rate. Similarly cotton mills also showed a progress, number of employees increasing from 2.60 lacs to 2.82 lacs while number of looms increased from 1.04 lacs to 1.16 lacs.

To sum up, we find that agricultural production did not suffer rather increased to some extent. Manufactures developed in a phenomenal manner. There was more employment. All these are positive indications of increase of national dividend under the influence of rising War prices and therefore was on the whole beneficial to India.

After the War, inflation in England was stopped, she adopted a policy of deflating her currency to re-establish the pre-War gold parity of sterling. Value of sterling began to rise due to the contraction of sterling supply. This rise in the value of sterling was further aggravated by world scramble for gold. Sterling was depreciated in terms of gold which itself lost half its value during War years. Due to the increased demand for gold after the War the value of gold rose

up, necessitating a very serious curtailment of English money supply to attain pre-War gold parity. This in turn required curtailment of rupee supply to maintain sterling or gold parity.

Immediately after the War i.e. on the 30th May, 1919, the Government appointed an expert Committee under the presidency of Sir Henry Babington Smith to report particularly on the rate at which rupee should be stabilised in view of possible future variations in the price of silver. The Committee recommended to stabilise rupee at 2s. gold. The Government accepted the recommendations of the Committee and reduced the legal rupee-value of sovereign from 15 rupees to 10 rupees. Towards the end of 1919 exchange rate was 2s. 4d. sterling and nearly 2s. gold. On the publication of the Smith Committee's Report there was a great rush to sell sterling bills and to convert sterling into rupees. This abnormal demand for rupees pushed up exchange to 2s.  $10\frac{3}{4}$ d. on 11th February, 1920. But this was a temporary speculative jump. With a steadily rising value of both sterling and gold, exchange was bound to turn against India. The inevitable followed. From that date exchange began to jump down at long strides. It became apparent soon that to maintain exchange at such a high gold rate Reverse Councils were to be offered and a huge volume of rupees were to be withdrawn from circulation.

The situation was further aggravated by the removal of War-time restrictions on trade and imports began to pour in *en masse*. Indian productions also were very keenly demanded by the Western countries to rehabilitate their industries on peace basis from

War-basis. But the purchasing power of the European countries were shattered by the war and continuous inflation even after the War. The failure of rains in India in 1920 and prohibitively high prices of food stuffs, forced the Government to retain embargo on food exports. Japan had a severe crisis in the same year and could not take her normal quota of cotton from India. The fatal decision of the Government to stabilise rupee exchange at 2s. gold made prices of Indian exports prohibitively high to the foreign buyers with shattered purchasing power. Import trade however increased very briskly. Inflation in the European countries helped this development considerably. During the War, Indian manufacturing industries could not be technically improved and reorganised for shortage of machines and plants which are all foreign made. Just after the War, huge quantities of such materials were imported. High exchange also helped these purchasers very considerably because rupee price of these machines fell very low. Due to the operation of all these combined forces balance of trade turned strongly against India and it was Rs. 79.80 crores in 1920-21 and Rs. 33.93 crores in 1921-22. India suffered an acute economic depression during these two years. The following figures will speak for themselves. (Jather and Beri).

*Value in crores of rupees a foreign trade of India.*

Year	Imports	Exports	Net exports
1919-20	221.7	336.02	+ 114.32
1920-21	347.56	267.76	- 79.80
1921-22	282.59	248.65	- 33.94
1922-23	246.19	316.07	+ 69.88

Year	Imports	Exports	Net exports
1923-24	237.18	363.37	+126.19
1924-25	253.37	400.24	+146.87
1925-26	236	386.82	+150.82

Now the Secretary of State require sterling resources to meet Home Charges and ordinarily these are obtained by selling Council Bills. The sale of these depends on favourable balance of trade, a normal Indian phenomenon. Hence the unfavourable trade balance put a double strain on the Secretary of States' gold resources—to meet Home Charges and to help the exchange.

The Reverse Councils had to be offered and at first they were offered at 2s. 8d. sterling. But inspite of these sales, the exchange rate did not only fall below 2s. gold but also fell below 2s. sterling which was depreciated in terms of gold. The Government then tried to maintain rupee exchange at 2s. sterling but that attempt also proved abortive. It was literally impossible for the India Government to keep pace with the terrific rate of deflation in England. By degrees, Government accepted defeat and they simply sympathised with the English policy by avoiding further inflation and giving effect to some token measures of contraction of rupee supply. These token measures could not stem the tide of falling exchanges which fell lower than 1s. 3d. sterling and 1s. gold in 1921. By January 1923, due to the improvement of trade balance, reaction began and exchanges improved to 1s. 4d. sterling and were tending to improve further. In October 1924 it rose upto 1s. 6d. sterling and this was equivalent to 1s. 4d. gold. Sterling was brought to

parity with gold by the middle of 1925 and rupee exchange also became 1s. 6d. sterling and gold. There was a further tendency of rupee exchange to rise but this was stopped by a free offer of Council Bills.

The contraction of currency began to reduce Indian prices and this continued indefinitely. From 1920 to 1922 the contraction of Indian currency proceeded from the suspension of the sale of Council Bills as well as the sale of Reverse Councils. From 1923 the sale of Reverse Councils were stopped but due to an improvement in the favourable balance of Indian trade, suspension of Council Bills also, meant a contraction of currency. But this contraction of currency was of much lesser dimension than contraction of English currency. That is why Indian prices fell much less in comparison with sterling and gold prices.

Contraction of currency by Reverse Councils continued right upto 1921-22 and prices fell considerably while they were rising rapidly in the previous years. The two years of contraction of currency synchronised with very serious economic depression. Recovery set in from the financial year 1922-1923. This was mainly due to the abandonment of any further attempts towards contraction of currency. For the four years following, India enjoyed a substantial favourable balance of trade and a very great and prosperous export trade. The serious deflationary policy of America and a very steep rise in the value of gold, encouraged the export trade of India very much. The virtually stationary price level in India during these four years helped the Indian producers in relation to the foreign consumers. The figures on page

107 and 108 will speak for themselves. From these figures one is tempted to infer that contraction of currency led to a serious economic depression in 1920-21 and 1921-23 and the abandonment of the attempts towards currency contraction during the four following years led to an improvement of the situation and the improvement was instantaneous and cumulative. Industries also recovered from the shock of two years of currency contraction and enjoyed four years of continuous prosperity. Agriculturists also were happy because of favourable foreign market and prompt sale of their stocks.

Looking to the period as a whole we must say that this was on the whole a period of economic prosperity for India. The year 1920 was the dividing line between rising and falling prices. The period of rising prices, barring the first year of the War shock, was one of general prosperity. Contraction of currency during the first two years of falling prices led to a sudden fall of prices and a serious economic depression. Giving up of attempt towards contraction, restored Indian trade and industry to their normal prosperity which continued upto the end of the life of Arbitrary Standard i.e. 1925. Again and again in Indian economic history we find that periods of rising prices are the periods of general prosperity and the periods of falling prices are inevitably the periods of economic adversity.

## CHAPTER VI.

### The Period of Dollar Standard ( From 1925 to 1931 )

We have seen in the last chapter that by the end of 1924, exchange value of rupee at 1s. 6d. sterling, was attained and by the middle of 1925, sterling arriving at parity with gold, the value of rupee also became 1s. 6d. gold. Tendency of the rupee to rise further in gold value was checked by resumption of sale of Council Bills and increase of rupee supply in India. Thus on the one hand, value of rupee became equal to 1s. 6d. gold and on the other hand, exchange mechanism was brought into operation again to retain its value there. From 1925 sterling became freely convertible into a definite weight of gold and the receiver of gold could dispose of it any way he liked. England became a full-fledged gold standard country. Rupee, being connected with gold by exchange mechanism, became based on gold. This situation continued upto 1931 in which year England again suspended gold payments and sterling was delinked from gold. But rupee maintained its sterling exchange mechanism at 1s. 6d. sterling and as such was simultaneously delinked from gold. Hence from 1925 to 1931, Indian currency was based on gold.

Gold is an absolute standard of value in the sense that gold is a world commodity. Its value is deter-

mined by the world demand for it on the one hand and the total available stock of it on the other. Gold is demanded not only for monetary purposes but also for industrial and ornamental purposes the two latter purposes absorbing an everdiminishing percentage of world supply of gold. Ordinarily industrial and decorative purposes consume a more or less fixed quantity of gold and change of demand for gold on that score does not generally occur due to changes in demand for gold for monetary purposes. Germany in 1870 decided to have gold standard with gold currency and her increased demand for gold made the world demand for gold greater and therefore raised its value to a higher level. After the Great War, the belligerents began to collect gold for reserves to re-establish gold standard. This scramble for gold meant an increased world demand for gold and raised its value. On the other hand, adoption of gold exchange and gold bullion standard in place of gold currency standard after the War meant a great economy of gold and a reduction in the world demand for it. The same reduction was effected by perfection of banking system which economised gold to a very great extent. On the other hand, decision of some central banks to increase gold reserves or to decrease gold backing of their notes increased or decreased the world demand for gold.

But it is not likely that all these forces will act in the same direction at the same time to increase or decrease the world demand for gold. Most of them, if they occur, may have opposite tendencies and as such will cancel each other. Therefore a particular

country need not bother itself, when it introduces gold standard, about these increases or decreases in the demand for gold by other countries. Again, gold in the modern world, is used only as reserves of the Central Bank, most of which have got gold reserves which are greater, by wide margins, than the minimum reserves required to maintain convertibility of currency in terms of gold. These sterilized margins of gold are sufficient to meet demands for gold from a country that wants to build a gold reserve or to make its reserves stronger still. Again, advent of gold in a country nowadays does not necessarily lead to increase of currency but is simply added to the reserve to make the reserve percentage against notes higher i.e. to make the sterilized margin a bit wider. For all these reasons a particular country need not be over anxious about the increase or decrease in the world demand for gold and to all intents and purposes, this should be assumed as constant.

On the supply side also, situation is equally satisfactory to make gold a very good basis of currency. Yellow metal is virtually indestructible and the annual production of gold is not even 2 per cent. of the existing stock. Hence annual production cannot be to such an extent as to affect the value of gold. On the other-hand when the value of gold falls, some inferior mines will go out of production and gold supply will even then increase but at a slightly lower rate. Hence annual production has practically nothing to do with value of gold which is determined by world demand for gold on the one hand and the total stock on the other. So far as other commodities are concerned,

their value is determined by cost of production but the value of gold determines the cost of production of gold.

The popular notion that the value of gold remains fixed is based on these peculiar demand and supply conditions of gold. Before the War, world conditions tallied with these assumptions and the value of gold changed but very little under stable demand and supply conditions of gold. But the World War has shaken these happy assumptions at their very foundation. United States emerged out of the World War as the strongest financial and creditor country of the world in place of a debtor country before the War. She joined the War only towards its later stage while at the beginning she sent war materials to belligerents in huge quantities which were paid in terms of gold. More than one-third of total world supply of gold was concentrated within her shores. After the War, there followed a great scramble for gold because all the belligerents, to re-establish gold standard, wanted to, procure gold. France also succeeded to collect a huge reserve of it and all other belligerents collected as much as they could procure. Nearly the whole of world supply of gold was thus concentrated in the central banks of the world, America collecting by far the greatest quantity, more than one third of the world, supply and France occupying the poor second position. These different concentrations of gold were not required to their full extent to maintain the convertibility of the currencies of the respective countries and some of the countries did not even resume gold payment inspite of substantial gold reserves. It will not be an overstatement to make that more than half of the

world gold supply, though ultimately meant for monetary purposes, was withdrawn from monetary uses and was lost to the currencies of the world. This amount of gold was sterilized and virtually hoarded underground and to all intents and purposes lost to the world. This was the same thing as Eastern hoardings which are accused by all Western economists, financiers and politicians. The vice of the East infected the West with vengeance because the hoardings of the latter were more organised, deliberate, preconceived and concentrated.

When the active and available supply of gold was reduced to one half, America exploited the situation for another purpose. She began her experiments at controlling the world value of gold. Concentration of gold during the War made American prices as inflationary as prices in the belligerent countries, in other words, value of gold fell nearly by one half of its pre-War value. Her practice of bottling and sterilizing gold began at that time and was probably meant for stemming the tide of rising prices. Since that time she has been controlling the value of gold in the most ruthless manner. She had a gold standard in the sense that dollar is convertible into a definite weight of gold. But when there was any divergence between the value of gold and dollar, she did not adopt the English method of controlling her currency. In England when the value of pound sterling fell below the legal weight of gold, people presented sterling to the Bank of England and took the legal amount of gold in exchange of notes. The notes thus encashed were cancelled and withdrawn from circulation. Thus

by contracting money supply, the value of sterling used to be pushed up to the level of gold value. In the reverse case when the value of sterling rose above the value of gold, people presented gold and took out sterling from currency office. This increase of circulation lowered the value of sterling to gold level. Thus the English method of maintaining gold standard was by manipulating currency supply, i.e. by adjusting the value of currency to the value of gold.

But the American method of maintaining gold standard was exactly the reverse. When the value of dollar fell below the value of the legal weight of gold, she unearthed some of her bottled gold, and threw it in the open market. Available and active supply of gold increased in the world market and its value became lower. The process continued till the parity was restored again. In the reverse case when the value of dollar rose above the value of legal weight of gold, she bottled some more gold from the world market, available supply of gold became smaller and its value went higher. The process continued till parity was restored again. In essence the American method amounted to increase or decrease of available world supply of gold to adjust its value to the value of dollar. She was unwilling to temper with the value of her currency. In other words, the value of gold was made to conform with the value of dollar. The dollar inspite of its parity with a definite weight of gold was therefore on arbitrary standard. England by maintaining the parity of sterling with a definite quantity of gold, was, in essence, maintaining parity

with dollar. English system became dollar exchange standard. Dollar and not gold became the standard of value in England. Indian rupee having had to maintain fixed exchange value with sterling, had the same dollar as her standard. Of course, dollar was on arbitrary standard and as such rupee was also on arbitrary standard. There was no fundamental difference between War monetary system of India and dollar exchange standard of the post-War period. But as this Arbitrary Standard was on the stereotyped dollar line, we term it dollar standard.

The restoration of gold-cum-dollar standard made currency conditions more stable both in England and India. It was time to solve the currency question finally and with that end in view a Royal Commission on Indian Currency and Exchange was appointed under the presidentship of Lieutenant-Commander Edward Hilton Young. The Report of the Commission was published in August 1926. The recommendations of the Committee can be grouped under three heads: (1) Monetary standard (2) Ratio of the rupee with the chosen standard (3) Creation of a central bank. The third group of recommendations does not concern us here.

Before the War, sterling was supposed to be the same as gold but the Great War proved that sterling might be very easily converted into a paper money. Gold Exchange standard of India was reduced to Sterling Exchange Standard in War period. For this reason the Committee recommended that gold should be made the standard of Indian money in the most unequivocal terms. In view of possible rise of

silver prices in future above rupee par the Committee recommended that one rupee note should be re-introduced and in case rupees were melted down for bullion, one-rupee notes should fill up the vacuum. The Commission welcomed such a contingency on the ground of economy because costly currency, silver-note, was to be replaced by a cheaper paper note. Both rupees and notes were to remain unlimited legal tender. Currency authority was to be under obligation to receive gold in exchange of notes and rupees and to pay gold for rupees and notes tendered to it. Notes were to be deprived of its convertibility into silver rupees. Gold-Bullion-Standard adopted by England was thus the model of Hilton Young Commission. The Commission recommended the rupee to be stabilised at 1s. 6d., the ratio that was existing at that time.

The Government of India accepted the report of the Hilton Young Commission and the Currency Act of 1927 was passed legalising 1s. 6d. ratio of the rupee and placing the Government under the obligation of buying gold in unlimited quantities at the price of Rs. 21 13as. 10p. per tola and selling gold at the same price to the holders of rupees and notes in unlimited quantities. The same Act deprived sovereigns and half sovereigns of their legal tender character in India. Gold coins were not to be circulated in India, specially for the sake of economy. Thus Indian currency system was firmly knotted with gold and as such with American dollar. Unfortunately neither the Commission nor the Government could realize that they were voting for a dollar standard.

The subsequent history of the rupee is the history of the dollar. If we look to the price level statistics of America, England and India from 1926 to 1929 we find that prices remained virtually stationary in America, index-numbers varying from 100 to 95. In England it varied from 148 to 137 and in India it varied from 148 to 141. Local divergences were sufficient to explain the minor differences in the three index numbers. Prices in all these three countries might be taken to be nearly stationary with a declining tendency.

If we look back to the trade statistics of India we find that both imports and exports, as well as favourable balance of trade for India from 1926 to 1929, remained virtually unchanged. Indian foreign trade seemed to have attained a stationary state. A look to the trade statistics will convince the reader that stationary prices must have led to a static condition of trade:

*Foreign trade of India. (Jather and Beri).*

Year	Imports	Exports	Net exports.
1923-4	237.18	363.37	+ 126.19
1924-5	253.37	400.24	+ 146.87
1925-6	236	386.82	+ 150.82
1926-7	240.82	311.05	+ 70.23
1927-8	261.53	330.26	+ 68.73
1928-9	263.4	339.15	+ 75.75
1929-30	249.71	318.99	+ 69.28
1930-1	173.06	226.5	+ 53.44
1931-32	130.04	161.2	+ 31.16
1932-33	135.02	136.07	+ 1.05
1933-34	117.31	150.23	+ 32.92
1934-35	134.59	155.04	+ 20.45

The sudden fall of exports and of net exports in 1926-27, from the average of three previous years was probably due to the stoppage of deflation in England and the restoration of gold standard in India. In the previous years deflation in England and a greater fall of prices in gold standard countries than rupee prices in India, were conferring a special stimulus to Indian exports. Adoption of the so-called gold standard in England and India put an end to this extra advantage and reduced Indian exports to a considerable extent and brought the favourable balance to less than one half. After this sudden fall, exports and net exports maintained a steady rate at a lower level.

From 1921 American prices and prices in all gold standard countries were falling. The fall was very precipitate in 1921 but thereafter the fall was not sharp but persistent. There were two main causes for this gradual but persistent fall. Nearly one half of world supply of gold was sterilized in the different central banks of the world which concentrated gold in greater amounts than their reserve requirements, America being by far the worst culprit. Demand for gold suddenly increased due to the scramble for gold in post-War years, for the restoration of gold standard all over the world. Banking development and gradual release of bottled gold saved the world from a summary collapse of world prices. In 1928 the world had a price level, 50 per cent higher than the price level, in 1914, with a stock of gold, greater only by 40 per cent while it should be remembered that world population and production increased considerably, increasing thereby world demand for gold and a considerable part of the

gold stock was bottled and not available for monetary purposes. This maintenance of higher prices was also helped by a confidence in the business world that things would turn out better and everything would be all right. There was hectic activity and the world, released from War troubles, concentrated on productive activities. A great increase of world production on the one hand and narrowing of the basis of money and credit on the other began to tell upon prices gradually but surely. Rupee being connected with dollar shared the same appreciation of its value.

Value of Indian exports is a fairly satisfactory indication of Indian rural prosperity. The adoption of this so-called gold standard led to a sudden fall of exports in 1926-1927, and rural masses began to suffer more and more. Though export crops were first affected, the producers of other crops also were gradually affected and agricultural depression became general. Indian industries were also very much hard hit and they were clamouring for protection. Depression in agriculture though not acute was sufficiently painful.

In this connection I should make a special mention of the ratio controversy of the rupee. The minority report of the Hilton Young Commission, signed by Sir Purushattamdas Thakurdas supported 1s. 4d. while majority supported 1s. 6d. The Government of course adopted majority report but from the subsequent development it became clear that the lower ratio would have served the Indian interests much better. It should be said to the credit of the Swarajist Party in the Central Legislature that they fought tooth and

nail for 1s. 4d. ratio. The lower ratio probably would not have reduced the export trade so drastically and industries also would not have been reduced to the position of begging for protection. The rise of prices, at least non-fall of prices, would have brought prosperity to agriculture and industries both.

But the climax of the dollar-story is yet to be told. In 1929, there was a speculative boom in the United States and the Federal Reserve Bank restricted credit in all possible ways and raised up their rate of discount. This attempt precipitated a very serious crisis in America known as Wall Street Collapse and forced the bank rate up to a panic figure. This high Bank-rate attracted funds from all other countries of the world and specially the debtor countries. Lowering of prices in America also enabled her to increase exports considerably and to discourage imports. Foreigners had to meet their liabilities in terms of gold because low prices in America, caused by curtailment of credit and prohibitive import duties, made it impossible to send things there. The other gold standard countries had to feel the pinch and prices collapsed suddenly.

The situation was aggravated by the policy of some other countries that had to raise their bank rates in order to prevent an excessive outflow of gold. The high rate for money in France which was also a great creditor country withdrew funds from outside, in gold, because low prices in France due to the curtailment of credit and prohibitive import duties made kind payment impossible. The lower price-level in the dollar country enforced lower price level in India as.

well. England also shared the same fate. But the case of India was specially bad because of summary withdrawal of funds from India and the disinclination of the foreign investors to invest money in India. This was caused by the scare of the Lahore Congress Resolution of 1929 to repudiate national debts under Congress Government in future. It is really regrettable that Congress should have framed such an irresponsible resolution at such an inopportune moment and should have made the bad situation worse. Jute, cotton and steel, the three main industries of India were hopelessly cornered by this sudden fall of prices. The prices of raw materials, foodstuffs and agricultural products in general fell very sharply and the exports of jute, cotton, coffee and groundnuts suffered very heavily. Export trade and net exports began to come down by big jumps. Rural masses were reduced to penury. Unemployment in industries became visible. The period of dollar standard had been one of the darkest chapters of Indian economic history and the suffering of the people under this standard was continuous, cumulative and acutest at its last stage.

## CHAPTER VII

### The Period of Sterling Standard ( From 1931 to 1937 )

Wall Street collapse of 1929 extended its wings over all the gold standard countries. To prick the stock exchange boom, the Federal Reserve Bank raised up its discount rate and curtailed the volume of credit rather drastically. The New York Stock Exchange suffered crash after crash. Sudden withdrawal of a huge volume of credit caused prices to fall very rapidly. A serious void was created in the volume of currency and this was to be, in that difficult time, filled up only by gold. This sudden rise in the demand for gold in America drained away the metal from other gold using countries where gold did not experience such a sudden appreciation of value. France, Germany and other European countries forced up their discount rate to stop an excessive drain of gold and was partially successful. India with her primitive banking organization, could not retain gold so successfully and had to part with a substantial amount of her gold reserves. There was a heavy demand to purchase gold and sterling from the Government and currency supply in India was seriously curtailed.

Curtailment of credit in America lowered prices of foreign goods first and by degrees all the commodities were affected. To save their gold reserves

European countries also reduced their volume of credit and lowered prices. Markets for Indian exports were thus paralysed and the volume of our exports valued at 339.15 crores in 1928-29, came down to 318.99 crores in 1929-30. It tumbled down to 226.5 crores in the following year and went on being reduced year after year. In 1932-33 it sank down to 136.07 crores and the balance of trade also came down to 1.05 crores while in 1928-29 balance was valued at 75.75 crores.

The paralysis of Indian export trade glutted the Indian market with surplus stock and worked as an additional factor towards lowering of prices. The diminution of the purchasing power of the Indian consumer reduced his demand for imports which began to fall rapidly, though not as rapidly as the exports were falling. This caused the balance of trade to diminish year after year as the depression proceeded and slump deepened.

There was also the psychological factor acting towards diminishing prices. Before 1929, a suppressed optimism was permeating the business community that everything would turn out better. The Stock Exchange boom of Wall Street in 1929 recorded the high water mark of that business optimism. After the crash, optimism was replaced by a sense of deep pessimism. The belief of the business community that everything would turn out ill made people unwilling to undertake production. Widespread failures of firms made new undertakings very hazardous. Some were ruined, others wound up their business with heavy losses and still others reduced their scale of operation. Unemployment began to mount higher and higher and

this in turn reduced effective demand, in turn the price level of the country. A vicious circle was established. Pessimism reduced the scale of production, smaller production created unemployment, lower employment reduced effective demand for things, lower demand diminished prices, lower prices again reduced production and so on in a vicious circle. The higher rate for money aggravated the situation and failures became general. This business pessimism was the main cause of the sudden and catastrophic fall of prices, first in America and then in other gold standard countries. In America the index numbers fell from 95 in 1929 to 86 in 1930, to 72 in 1931 and to 64.5 in 1932. In India the index numbers of Calcutta wholesale prices fell from 141 in 1929 to 116 in 1930, to 99 in 1931 and to 91 in 1932. Prices of Indian exports fell much more than prices of imports because American and European purchasers were paralysed first and Indian purchasers were paralysed afterwards and in consequence. Miseries of the agriculturists during these years beggar description. But for efficient railway and famine relief organization, India would have suffered from a wide spread famine. Indian industries also were in a pitiable plight during these years of depression.

England suffered the same fate with India and had to suspend gold payment on September 21, 1931. On the same date India also suspended gold payment and linked rupee to sterling at 1s. 6d. sterling. England stopped further deflation with the suspension of gold payments and India being now linked to sterling was spared of further deflation.

Indian Reserve Bank Act of 1934, has made Reserve Bank, the currency authority of India. The Reserve Bank is now under the obligation of maintaining 1s. 6d. sterling ratio to the rupee by selling sterling in unlimited quantities or buying sterling in unlimited amounts. The defacto sterling ratio was thus legalised by the Reserve Bank Act and Sterling Exchange Standard was firmly established.

Though after the assumption of independence by suspending gold payment, England was not required to strike the deflationary hammer on her currency, still she could not restore confidence of the business world nor could she revive the purchasing powers of her or foreign consumers. The only immediate and visible effect of this suspension was the fall of gold value of sterling as indicated by dollar sterling exchange which began to turn against England. In India also, gold value of rupee began to fall i.e. the price of gold began to rise. By the end of September 1931, price of gold was Rs. 29-2-0 per tola while before suspension it was Rs. 21-13-10 per tola.

But the stoppage of further ~~in~~<sup>de</sup>flation due to the adoption of sterling standard did not improve the purchasing power of the foreigners who bought our raw-materials and other exports nor did it appreciably improve the business confidence of the world. Japan suspended gold payments in the same year and began to inflate her currency and imports from Japan flooded the Indian market but Indian exports did not get any advantage there, rather were put into disadvantage because of Japanese inflation. Volume of exports and balance of trade continued to deteriorate. Price-level

sank lower and lower. The index numbers of Calcutta whole-sale prices were 143 (see page 91) in September 1929 and 91 in September 1931 taking July 1914 as the base 100. Thus by the end of 1931 it fell below pre-War level. It further fell to 88 in December 1932 and by December 1933 some improvement was visible and index numbers stood at 89. In March 1935, index numbers still stood at 87 which was much lower than pre-War level.

By the end of 1933 signs were visible that the forces of depression were working themselves out. Interest rate was coming down in all the countries and confidence was gradually returning. After the suspension of gold payments in India, currency authority did not provide gold for foreign payments but the people found their own remedy. Rise of the price of gold, and paralysis of export market provided the sufficient stimulus to Indian peasants to sell off a part of their gold hoards and to export that for liquidating their foreign obligations. This saved the Indian peasants from extreme hardship and privation in the most difficult days and procured for them a very high price for their hoardings. From the days of suspension of gold payments to the middle of the year 1936, gold valuing 274 crores of rupees was exported. These gold exports began to have favourable effects on balance of trade and converted idle hoards into live capital.

But inspite of these palliatives, economic condition of the people did not sufficiently improve. Prices up-till now may be said to have remained constant and there is no sign of appreciable rise. Only in British

India the value of the principal crops fell from Rs. 1021 crores in 1928-29 to Rs. 474 crores in 1933-34. The difference was the amount of loss of purchasing power suffered by the agriculturists of British India. They have been specially hit hard because, inspite of the reduction of their receipts, their dues to the Government remained of the same money value, rather tended to increase. Debt liabilities of the Indian peasants also became heavier in real value. Economic depression also strained the Government finances. With the diminution of agriculturists' income tax returns were below expectation and newer sources had to be tapped and older taxes had to be made heavier in rates. Government had to effect retrenchments as well but even then there were deficit budgets. Lower purchasing power of the rural masses and higher burden of taxation adversely affected Indian industries as well though depression was not as serious as in agriculture.

Indian public opinion is very hazy about the real cause of the present economic depression and is hazier still about measures that will relieve the tension. Some maintain that free export of gold from India has aggravated the situation and if the Government could retain that gold, price level would have risen due to bigger reserves. But this contention is childish. Gold could have expanded the currency supply only if India remained on gold basis. Changing of the basis of Indian currency from gold to sterling has increased the volume of Indian money because the gold value of rupee has become lower. Again, export of gold did not aggravate the depression but has helped to relieve the situation considerably. The sterile gold

saved the Indian farmer from extreme penury and paid for his exports. Stone was converted into consumable article and that at a very advantageous price. Situation would have been worse still without gold export.

The movement for 1s. 4d. sterling ratio for the rupee deserves a more respectable reference. If Indian currency was inflated to this extent, the situation would improve considerably. To maintain 1s. 6d. ratio Government had to keep bank rate very high and to contract currency oft and on. From 1929 onward Government had to meet Home Charges from their gold and sterling reserves and in 1931 they had to contract currency by selling sterling worth £5.6 millions and these selling of sterling were taken recourse to intermittently. If the lower ratio of 1s. 4d. were chosen, currency would not be required to be contracted like this and fall of prices would have been arrested, the balance of trade would have improved and exports would have considerably increased. These contentions are true and based on sound theoretical basis and practical experience. Lately America and France also have gone off gold standard and helped themselves with a bit of inflation. These steps of the most obstinate gold standard countries have given further strength to the arguments of the inflationists who deserve every encouragement and sympathetic consideration. But neither the monetary authorities nor the public are thoroughly convinced that inflation can bring millennium for any country. They are blind believers in the quantity theory of money and consider that money is simply the measuring rod of value and it is a matter of indifference whether the rod is bigger or smaller.

Only rule to be observed about money is that the length of the measuring rod should not be changed. This firm belief of the Government, with the theories of eminent economists behind, have made them extremely dogmatic and conservative in their monetary policy and the same belief, lurking in the subconscious of the public, have made them tacit consenters in the Government policy inspite of their extreme sufferings on occasions.

## CHAPTER VIII.

### Reformed Gold Standard: the ideal of Classical Economists.

We have come to the end of Indian currency history. India had bimetallism, silver standard, gold standard and arbitrary standard during different periods of her history. These different standards may be classified under two heads, inflationary and deflationary. Silver standard, gold standard, War arbitrary standard (from 1914 to 20) were inflationary while arbitrary standard from 1893 to 99 and post-War arbitrary standard from 1920-37 were deflationary. Inflationary periods were also the periods of prosperity and deflationary periods were and have been periods of economic adversity without exception. For this reason Indian opinion seems to welcome rising prices and shudders at the idea of falling prices. At this stage, we are not in a position to establish a causal connection between the two but there is an under-current of feeling that rising prices bring prosperity and falling prices bring adversity.

But the teachings of the classical economists cut at the very root of this faith. Money, they maintain is simply a measuring rod and it is a matter of indifference whether the rod is longer or shorter. If the rod is shorter, it is to be used several times more to measure a particular thing than if it were longer. Like any other economic goods, value of a unit of money also, depends on the total quantity of money. Greater

the supply of a particular commodity, lower is the value per unit of that commodity. This principle has been named the law of demand in economic science, and is one of its rudimentary axioms. Money also does not form any exception to this rule. Some economists have gone to the extreme of establishing an inviolable mathematical relation between the quantity of money and its value per unit. When the quantity of money doubles, value per unit halves and when quantity halves, value doubles. Thus the value of money varies inversely as its quantity.

This mathematical relation between the quantity of money and its value is proved from the fact that money has no value in use but it has only value in exchange. If a man lose a four anna bit he is deprived of an amount of consumption measured by four annas but the society as a whole is not loser thereby on the whole. The commodities that would be bought for this four anna bit remain in the market. The four anna bit of other persons will now purchase more because the share of the total product, that would have gone to the loser of money if he had that four anna bit, is parcelled among the rest of money holders in proportion to their holdings of money. Thus the diminution of the volume of money in any percentage increases its value by the same percentage and an increase in the volume of money decreases its value in the same ratio. This is the same thing as saying that the total value of money is fixed. Hence if the volume of money is suddenly doubled, double the arthmetical quantity of purchasing power is offered to purchase the same stock of commodities and each unit

of money will buy half the previous amount and if the volume of money is suddenly halved, half the arithmetical quantity of purchasing power is offered for the same stock of commodity and each unit of money will buy double the amount. In both the cases people will neither be any the better or any the worse. Every one will be able to purchase the same amount and combination of commodities as before. What they could do with double the amount of money, will be done by half the amount. Hence a greater or smaller quantity of money is of no social consequence and as a corollary to this, rising and falling prices are matters of indifference to society. Rising and falling prices can neither improve nor deteriorate the economic conditions of a society.

But these inferences are true if prices of all the commodities rise or fall at a uniform speed. In that case the relative positions of the parties to exchange do not change. But if the prices of some things rise or fall, with the rise or fall in the total volume of money, more promptly than others, rising and falling prices assume social significance. With the increasing volume of money and rising prices, the producers of those commodities whose prices are lagging behind suffer as purchasers of those commodities, value of which are increasing more rapidly. In the reverse case, when volume of money is decreasing the producers of those commodities whose value is not falling in step with the volume of currency, gain as purchasers of commodities whose prices have fallen *pari pasu*. But these advantages and disadvantages are only temporary because competition will force the losing

producers to reduce their scale of production on the one hand and will impel the gaining producers to increase their scale of production on the other, making the condition of all the producers identical in the long run. Thus the advantages and disadvantages are simply the phases of transitional stages and are obliterated by the force of competition in the long run. Rising and falling prices therefore retain no social significance in the long run. But this is also to be admitted that dislocations they cause during transitional stages are not also of negligible dimension.

In our society, organised on the basis of division of labour, a person can get his income because others demand his services. If the volume of others' money income offered for his services varies in the same proportion as his money income, changes in the value of money is of no significance to him. But as a matter of fact people enter into advance contracts by which they are to give some services in exchange of definite amounts of money. Of course there are many who do not work on long contract basis and can easily adjust themselves to the changed conditions created by the variations in the value of money. Therefore people who work on long contract basis suffer by a rise in prices i.e. by a fall in the value of money and the latter class of people who can easily raise their incomes with rise of prices gain at the expense of the former class because they can buy their services at the old rates with their higher incomes. By a fall in the value of money all the loan contracts become disadvantageous to the lenders and advantageous to the borrowers. Let us suppose that A lent Rs. 100 to B

at 10 per cent. p. a. interest and before the time of repayment the value of money has become half. At the end of the year B pays back to A Rs. 110 but the value of each rupee falling to one half of its original value, the amount is only worth Rs. 55 according to pre-rise basis. Thus the lender has suffered a loss of Rs. 45 and the borrower has pocketed that amount. Thus the fixed income earners and lenders suffer by a fall in the value of money and gain by a rise in the value of money. The businessmen on the otherhand gain by a fall in the value of money at the expense of the former class and lose by a rise in the value of money to the merriment of that class. Thus a change in the value of money means an arbitrary redistribution of social wealth and as such is morally unjust.

Fluctuation in the value of money not only brings arbitrary redistribution of wealth but also has an adverse effect on the production of social wealth. The present capitalistic productive system depends on the basis of contract and anticipation. Long preparatory stages are needed before a thing can be marketed now-a-days. Hence production is to start on the hypothecation of a certain level of prices and then entering into voluntary but binding contracts with a multitude of people to do certain things for fixed money payments. But fluctuations in the value of money cut at at the very root of the basis of productive activity and make people unwilling to enter into contracts unless these are to their advantage by safe and wide margins. Thus fluctuation in the value of money adds another element to the cost of production of a thing as

insurance premium, on the account of uncertainty and tend to dampen productive activity.

The effect of rising and falling value of money should be clearly understood. When the value of money rises the money cost of the businessman does not decrease sufficiently because most of his expenses are on long-contract basis, but the money receipt for his wares fall. This brings loss to businessman who is forced to reduce his scale of production. Thus the effect of rising value of money on production is not difficult to understand. But when the value of money is falling the businessman's expenditure does not increase sufficiently because wage bill and interest charges become lower and lower in real burden while the receipts of his ware are rising. This increases the profit of the businessman who therefore expands his scale of production. This rising price i.e. falling value of money, increases the production of wealth.

Classical Economics maintains that this increase of businessman's profit and production, is rather fictitious than real. Businessman's profit is at the expense of those who provide him services and loans on long contract basis. What he gains is lost by others. Therefore from the standpoint of society it means no net gain. This illegitimate profit of the businessman urges him to produce more commodities. But assuming normal conditions, that is adjustment of demand for and supply of commodities before the rise of prices, this new increase of production must be in excess of demand. For the time being, the excessive production may not be apparent but sooner or later this is bound to end in a crisis and widespread failures of business.

The losses to the businesses in the longrun and in a crisis, will far exceed the initial gains. Again, the misdirection of the productive energies of the nation by illegitimate profits amounts to a waste of productive power and is injurious to the society on the whole.

Thus we find that though rising or falling prices are of no social significance in the longrun still during transitional stages they cause arbitrary redistribution of national wealth and dampens or misdirects the productive forces of the nation. Hence the only logical policy about money is to keep its value absolutely fixed. This will allow the productive powers of the nation to be utilised properly and to the best advantage and will allow everyone to enjoy the benefit of the fruit of his labour.

India Government seem to be a faithful believer in the classical theory and there are positive evidences that they always abhor the idea of increasing or decreasing the value of money for any reason whatsoever. In the ratio controversy of the rupee at the time of enacting the Currency Act of 1927, the Government adamantly stuck to the 1s. 6d. gold ratio of the rupee mainly for the reason that the ratio had been already in existence for sometime past and people had adjusted themselves to that ratio. Again in 1931, the Government suspended gold payments mainly for the reason that sticking to gold standard meant a serious contraction of money supply in India and raising up the value of money. The Government connected rupee to sterling, at 1s. 6d. per rupee simply for the reason that sterling seemed to be more stable in value than gold or dollar. Of course mischievous people

suggested that rupee was linked to sterling for facilitating English trade in India. But this is entirely erroneous. Gold standard and its necessary corollary deflation would have facilitated English exports to and investments in India much more than Sterling Standard. The burden of Home Charges also would have considerably been lightened. All these advantages were forsaken by the Government only for the sake of greater stability of the value of money. When in 1935 Mr. Manusbedar, President of the Indian Merchants' Chamber and Bureau, in presenting an welcome to the Finance Member on his arrival at Bombay, requested him to lower the rupee ratio, Sir James Grigg resentfully remarked that he would not be a party to 'monkeying' with the value of rupee.

The sterling Exchange standard is simply a provisional expedient and was adopted in 1931 for the reason that it was found to be less unstable than gold. The preamble of the Reserve Bank Act, that has legalised Sterling Exchange Standard, provides that the Standard of Indian currency should be permanently fixed up when international monetary situation becomes normal in future. According to clause 55 of the Act, the Bank is required to send a report to the Governor General in Council regarding the permanent standard of Indian currency when time becomes more propitious to introduce successfully such a standard. Inspite of the provisional nature of the Sterling Exchange Standard there is one very strong point in its favour. India Government have to make a huge annual sterling payment called Home Charges to England. If India adopts some other standard than

sterling, the rupee value of that payment will fluctuate and the India Government's budget will be a gamble of rupee-sterling exchange. This was the main consideration why silver standard, inspite of its brilliant record, was sacked in 1893. But India Government have lately shown unmistakable signs of sacrificing this advantage for the greater advantage of India in the fixity of value of her monetary unit. It seems, India is waiting, for America and France to release their bottled gold so as to allow its value to be determined by the natural forces of its demand and supply, to re-adopt gold standard. The India Government seem to subscribe to the popular error that the value of gold does not change.

India had gold standard before. From Akbar's time to 1873 due to the existence of bimetallism, gold standard and silver standard had no difference. India had a full-fledged gold standard from 1899 to 1914. Hilton Young Commission strongly advocated a gold standard for India and India adopted it in 1927. Circumstances forced it off from gold standard in 1931 but India is waiting for a suitable opportunity to re-introduce it. But though people erroneously suppose that the value of gold does not change still there have been and there are possibilities of violent fluctuations in the *value of gold*. In the 19th century there are distinct periods of rising and falling value of gold. In the 20th century, the fluctuations in the value of gold have beaten all records. Fluctuations in the gold value may be put under two heads: natural and artificial. Taking an account of annual production of gold on the one hand and production of commodities on the

other, it will be observed that increase of commodity production is proceeding roughly 2 per cent. ahead of gold production. This tendency is likely to be accentuated with the lapse of time because the experts on gold production opine that the future output of mines, specially South African mines that yield one half of world's gold production, will gradually but steadily decline. Thus even assuming free mobility of gold and the suspension of bottling practice, price-level of things is likely to fall near-about 2 per cent. annually.

Over and above this natural difficulty of gold standard in guaranteeing a fixed value for itself, there is another artificial difficulty. According to the pre-War practice of gold standard countries, amassing of gold necessarily led to the rise of price-level. But contrary to that practice America during the post-War years did not increase her currency and credit inspite of her very large imports of gold. She started the practice of sterilizing gold by bottling it up so that it might not influence the volume of currency. France also began the same practice and other countries being freed from War, wanted to procure the necessary reserves of gold to reintroduce gold standard. A scramble for the metal followed and this raised up the value of gold and gold standard currencies to a panic height.

Another fact needs be specially emphasised. America, in the post-War years maintained gold standard in the sense that dollar was convertible into a definite weight of gold. But neither the total volume of money in America nor the value of dollar depended

on the value of gold, rather the value of gold was dependent on the value of dollar. When the value of dollar began to fall in terms of gold, she unearthed some of her bottled gold and sold it off in the open market. Active supply of gold in the world market increased and its value came down till parity was reached again. In the reverse case, when the value of her currency began to rise in terms of gold, she bought off from the open market a supply of the metal and sterilized it by bottling it up. This reduced the supply of gold in the open market and raised its price till it attained parity with the dollar again. Thus so far as America is concerned, gold was treated as the servant of the currency and not as the standard of value. America, by her ruthless policy, has deprived gold of its most vital property of an absolute standard. Gold is no longer a thing to which value of currency is adjusted but it has come down to the position of its value being adjusted to the value of dollar currency. Gold is not the standard of dollar but the dollar is the standard of gold. Post-War gold standard currency systems were therefore all dollar standard systems.

India also tasted this system from 1925 to 1931 and is intending to have it again. But the unpalatable fact remains that gold-cum-dollar standard cannot be better than sterling standard. Sterling standard is rejected on the plea that even if the value of sterling is kept absolutely fixed in England in terms of English commodities its value cannot at the same time, remain fixed in terms of commodities in India. The composition of English commodities against which sterling is weighed is different from the composition of Indian

commodities in general and the sterling valuation of two different combinations must be different. Sterling value need not necessarily be kept fixed even in terms of English commodities and it will be manipulated to serve the English interests best. No one can possibly go to the extent of maintaining that the monetary policy which serves the English interests best will necessarily serve the Indian interests best. Thirdly sterling is on an arbitrary standard. Linking rupee to sterling means one blindman leading another. For all these reasons, sterling cannot be a suitable standard of value. But all these arguments are applicable against gold-cum-dollar standard with equal force. American combination of commodities are different from Indian. Dollar value is not always kept fixed even as regards American commodities and dollar is on an arbitrary standard. Hence gold cannot serve our purpose even as a tolerably fixed standard of value.

There is one advantage to be gained from this dollar or sterling standard: values of internationally traded commodities will remain the same. But for the so-called advantage of relative fixity of internationally traded goods, it is not wise to sacrifice the fixity of the value of goods in general in India. The advantage, from a partial fixity of value of rupee, in other words, relative fixity of the foreign value of rupee, will necessarily be lesser than the advantage to be derived from the fixity of value of rupee in relation to commodities in general. The whole is always greater than a part.

But a reformed gold standard, as hinted by World Monetary Conference held at Genoa in 1922, may

serve our purpose as an ideally fixed standard of value. The knowledge that the value of gold could be controlled by the manipulation of a single country made the Conference suggest to control the value of gold in such a manner as to keep it absolutely fixed. The methods of bottling up and releasing of gold by America have been her policy of changing at will, the proportion of gold reserves held by Federal Reserve Bank against its notes and deposits and the policy of alternatively issuing gold certificates and Federal Reserve Notes, both being legal tender money. Gold certificates are backed by cent per cent gold while Federal Reserve Notes are backed by 40 per cent gold. Therefore the issue of Federal Reserve Notes in place of gold, amounts to the release of 60 per cent gold for open market, the volume of money remaining intact in America. When she required releasing of some gold, America replaced some gold certificates by Federal Reserve Notes and when she wanted to bottle up some more gold she had simply to replace some federal reserve notes with gold certificates. Now, what was possible for one Central Bank, will be very easy by a combination of the prominent central banks of the World. If the leading central banks come to an understanding not to bottle up any gold but to economise the use of gold by keeping a diminishing percentage of gold reserve against their note issue and credit, they will be able to keep the value of gold absolutely fixed. In that case gold will become the ideal standard of value. The art of economising gold, first by note issue and thereover by deposit money, has been perfected to such a high degree that a very slight

lowering of reserve percentage each year will attain the purpose of keeping the value of gold fixed.

But the adoption of a reformed gold standard for India is nothing but an idle imagination. As this standard is conditional on an understanding amongst the leading nations of the world and as this understanding is not forthcoming, reformed gold standard is not a practical proposition. But any country can realize the substance of the reformed gold standard without having gold at all. Because, when by manipulation, value of gold is so regulated as to keep the price level fixed, gold standard becomes simply a titular monarch and can be replaced by an index number standard. Gold may be allowed to continue but no harm will ensue if it is done away with. Gold is not the standard; a fixed price level to which the value of gold is adjusted is the standard. India can therefore adopt an index numbers standard straight away.

That the value of gold can be manipulated by human agency is only grudgingly admitted by ordinary men. If gold is discarded by the world, as monetary standard and medium of exchange, its value will fall to a very low level according to this theory of manipulation. Why does not the value of gold now fall, retorts the dissenter, when gold is no longer monetary standard and currency of the world? Gold seems to be of high value per excellence and independent of human manipulation. The solution of this mystery is not far to seek. Though gold has been discarded as the standard of value and medium of exchange, still these are only temporary expedients. All the coun-

tries of the world are in the wait to jump on any lump of gold that will be released from anywhere. Gold standard has been discarded because of the unsatisfied demand of some countries and that demand has caused its value to rise lately to panic height. That demand, even now, remains unsatisfied and every country is wistfully looking for capturing more gold. This lust for gold is keeping up its price. If all the countries get disgusted and forsake the lust for gold, its value will suddenly sink down to nearly nothing. Hence the present high value of gold does not disprove the contention that the value of gold can be manipulated.

But once it is decided to have reformed gold standard or in the absence of international understanding, an index number standard, it may be asked what index numbers should be accepted to stabilise the value of rupee? The most fundamental index numbers are either the price-level of composite commodity representative of consumption or the command of human labour over money. Significance of money to human beings lies only in its connection to human consumption or to productive power. The aim of Indian monetary policy should be to keep the index numbers of the price of the composite commodity representative of consumption steady or the power of money to command the amount of human effort constant.

The adoption of an index number standard may involve India into sterling-rupee exchange difficulty in view of the fact that Government have to pay Home Charges in terms of sterling. It has been already explained that the consideration of greater well being of India has persuaded the Government to be ready

to sacrifice this advantage of sterling standard. If the Government can firmly stabilize the value of rupee, exchange difficulty can arise only from the fluctuations of the value of sterling or from the alterations in the term of trade between England and India. If sterling is inflated, the rupee burden of the Home Charges will be lightened and as such the question does not arise. If however sterling be deflated, the rupee burden of the Home Charges will increase. But deflationary policy is ruinous to trade and industry and England is not likely to indulge herself in such a disastrous policy again. As a matter of fact she gave up gold standard in 1931 because sticking to that standard meant continuous deflation. But no one can perfectly foresee the future and changed circumstances may force England to adopt a policy of deflation. Again, terms of trade are likely to turn in favour of India more and more in future because prices of raw materials and foodstuffs, the principal Indian exports, are rising much more than the prices of manufacturing commodities, the chief exports of England. In that case exchange is likely to turn in favour of India and the difficulty of the Government will lighten rather than increase. But under unforeseen circumstances, even those probable tendencies may be reversed and exchange may go against India.

The possibility of such an unfavourable turn of exchange, inspite of its improbability, must be recognised and the problem must be squarely faced. It is better for the India Government to convert their sterling obligations into rupee obligations as early as possible. India has accumulated by now a vast

volume of saving which is eagerly looking for secure investments. This is clear from prompt absorption of Government's floatations. Rupee loans should be floated and with their proceeds, the foreign obligations should be liquidated. The salaries of foreign army and civil officers also should be converted into rupees to get rid of these anomalous sterling obligations. No self-respecting government should have such a huge obligation in terms of a foreign money. It cannot but disturb the domestic economy of the country. The consideration of sterling obligation should not stand on the way of establishing reformed gold standard or index number standard for the greater good of India.

No other alternative system can guarantee an absolutely fixed value of money. Silver cannot do this. It will be too much to expect that relative production of silver on the one hand and all other commodities on the other will always remain the same. The combination of gold and silver in bimetallism also will not attain this parity of production. To attain fixity of value of money, some form of managed currency is the only possible method. If the inference of the classical school of economics that a fixed value of money serves the economic interest of a community best, be true the world has got to seek its refuge in the Index-Number Standard.

## CHAPTER IX

### A Critical Examination of the Postulates of Classical Theory

In the previous chapter it has been made sufficiently clear that a fixed value of money is the best for an economic community and in the long run money cannot effect any fundamental change in the economic activities of men. The same economic activities and the transactions of the same kind, nature and magnitude will be carried on whether with more or with less money and society will not be any the worse or better. A greater quantity of money will simply push up the price-level proportionately and a person shall have to pay for a thing say two bits of coin in place of one before and the reverse shall be the case when the quantity of money becomes smaller. Only during transitional stages there are some arbitrary redistribution of social wealth and shaking of the basis of production but these disadvantages are levelled down and smoothed in time. There is no long run consequence of a greater or a smaller quantity of money and from the point of view of society, quantity of money is a matter of indifference.

This view of economists is only grudgingly accepted by ordinary men and that because the arguments of the economists seem to be apparently incontrovertible. But inspite of the arguments of the economists, popular view connects economic prosperity

with increasing money and rising prices and adversity, with falling prices and decreasing money. Mercantilism still lingers on even amongst the most enlightened public men and editors all over the world. Advent of gold in a country is acclaimed by citizens and departure of gold is deeply deplored. Advent of gold is followed by business and productive activity while departure of gold leaves behind it a business and productive depression. This is the basis of the popular idea about the effect of quantity of money. The prominent events of history also lend support to this popular faith.

Stock of gold and silver was very small during the Middle Ages and in the Renaissance period and the world price-level was very low. In the 16th century the Spaniards began to bring in Europe huge quantities of gold and silver from America. The Spaniards conquered Mexico and Peru during the third decade of the 16th century and captured their specie supply accumulated through centuries. More important still, they discovered there some very productive mines, specially the mines of Potosi during the fourth decade of that century. Colossal supplies of precious metals were brought to Spain though a part of it was intercepted by the Dutch and English pirates. The pirates also, took the intercepted treasures to their own countries in Europe. The Spanish specie was partly put in circulation in Spain and partly spent in waging wars in France, Germany, Italy and Denmark. This way or that, the specie was distributed all over Europe. The following table provides a rough estimate of these colossal importations of gold.

	Gold (ounces)	Silver (ounces).
In 1493	17,682,500	225,050,000
In 1544	26,202,250	295,458,500
In 1600	38,322,800	771,600,000
In 1660	48,225,000	1,005,330,500

According to Taussig's estimation the total value of specie was \$580 million in 1493, \$1620 million in 1600 and \$2500 million in 1660. In 1660 prices were three times as high as in 1493 while specie supply increased more than four times during this period. That prices did not rise in proportion to the specie increase, is to be explained on the ground of a steady increase of industrial production. During the whole of this period a change in the industrial method was going on and by the middle of the 17th century it amounted to a virtual transformation of industrial technique. The supply of the precious metals continued to increase at the same rate even after the middle of the 17th century as it had been increasing since the middle of the 16th century. In the 18th century the supply was increasing a bit faster. But since the middle of the 17th century prices ceased rising. By the middle of the 18th century a downward tendency of prices became visible and by the beginning of the 19th century this tendency became more pronounced. The explanation of this stagnation and downward tendency of prices was to be found in the increase of productive activity. By the middle of the 17th century industrial productions were increasing at par with specie increase. By the middle of the 18th century industrial and agricul-

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\* Wiebe's Geschichte der Preisrevolution im 16 und 17 Jahrhundert, p. 281 as quoted by Taussig. Principles of Economics. Vol. I p. 254 converting kilograms into ounces.

tural productions far exceeded the rate of specie increase. After the middle of the 18th century Industrial Revolution came in full swing and production increased on a hitherto undreamt of scale and inspite of great increase of specie, specially the white metal, price level fell rather sharply.

Gold mines of California and Australia were discovered in 1848 and 1849 and these were in full productive activity by 1850. After 1850, the annual production of gold increased twelve times. During the third quarter of the 19th century world production of gold was equal to the total production of previous three centuries and a half. Inspite of the phenomenal increase of specie, prices rose from 1850 to 1875 by about 25 per cent. This irresponsible increase of prices as compared with specie supply was due to the continued increase of productivity with an accelerated rate during this period.

By the demonetization of silver in 1873, Europe and America suddenly lost a substantial part of their currency supply, leading to a precipitate fall of prices and there was the worst economic depression in their history during the 4th quarter of the 19th century. After 1890, however, production of gold increased sharply and this was due to the application of improved processes in gold mining enabling profitable working of low quality ores of Transvaal and the United States. While the annual production of gold in the eighties was \$100 million, it rose up to \$250 million in 1900 and to \$455 million in 1919.<sup>1</sup> This tremendous increase of gold supply arrested the fall of prices in

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1. Taussig's estimations: *Principles of Economics*, Vol. I.

Europe and America by 1900 and thereafter a rise of prices followed. But prices lagged far behind the increase of specie supply. This was due to the renewed productive activity after 1900 and increase of commodities with the increase of specie.

Popular view, has always attributed the phenomenal increase of productive activity, from the time of the discovery of Spanish America mines to 1873, to the increase of specie during that period. On the other hand it traces the origin of the economic depression of the 4th quarter of the 19th century to the abrogation of bimetallism and demonetization of silver and the revival from the beginning of the 20th century to the increase of gold supply specially from the South African mines. From the beginning of the 16th century to 1875 the connection between specie supply of a country and its economic prosperity became so very close that it created a class of economists known as mercantilists who argued that the wealth of a country was equivalent to its specie holdings and every country should devise and adopt all possible methods to increase specie supply. This mercantilist view, though not upheld nowadays in its crude form, is nevertheless the view of general public, politicians and statesmen right up to this day.

The public of India also seems to be mercantilist in spirit. It connects causally the economic prosperity of India from 1873 to 1893, while Europe and America were suffering from the most serious economic depression, to the depreciating silver standard of India and the suffering of the closing years of the 19th century to the closing of silver minting. Economic prosperity

from the beginning of the 19th century is attributed to the adoption of gold standard and the considerable imports of gold into India. Indian economists and specially the Bombay School of Economics, true to the doctrines of classical school, have been systematically arguing for an orthodox gold currency and a stereotyped stabilization and have opposed the policy of depreciation while the businessmen have been arguing for the depreciation of the value of rupee. The tragic sight of this contradiction became palpable when in the ratio controversy of 1927-1928, Indian politicians wanted appreciating gold standard as a concession to the economists but fought vehemently for the simultaneous devaluation of rupee from 1s. 6d. to 1s. 4d.

Inspite of the intellectual gymnasium of the misguided economists, common sense completely agrees with the popular view that supply of money has got a very direct connection with the volume of production and employment and as such, the supply of money is not a matter of indifference to society. Stimulation of production and increase of employment by an increased supply of money and a depression of production by a reduced supply of money are facts too hard to be poohpoohed away. The connection between the supply of money and volume of production is so very patent that it is really astonishing how the economists could persuade themselves to hold the contrary view. Let us take the help of an example to illustrate the popular view. Let us suppose one "Mr. A." works in a cycle factory on a monthly salary of Rs. 100 and on the 15th of the month, though his pocket happens to be empty, he wants to buy a

cycle for say Rs. 100. He applies to a bank for the accommodation and gets it because the bank happens to be well supplied with funds at the moment. With the borrowed amount he buys the cycle. The cycle dealer finds the stock of his cycles depleted and orders for more cycles from the factory. The factory enjoys the full swing of production and keeps all in employment. The worker after getting his salary at the end of the month liquidates his debt with the bank and the eternal cycle goes on. But on the other hand if we suppose that the bank at the moment is short of funds, the worker will not get any loan, the cycle dealer cannot sell his cycle, the factory does not get any order for cycle and has to reduce the scale of its production and may have to throw the worker out of employment. Diminution of money thus positively reduces production and employment while increase of money does the reverse.

Let us then take into consideration a model loan operation of modern days. Let us suppose a bank advances a lump sum to an entrepreneur. He starts a factory, gives employment to many and produces a certain thing. The consumption demand of his employees gives employment to another batch of people and leads to further increase of production and so on. Thus an increased supply of money, increases production and employment and the withholding of such a loan will have contrary effects. With the increased supply of money price level needs not increase, it may remain stationary because with the increased supply of money commodity supply also increases. This far is however certain that though prices may increase with

increased supply of money still these will not increase in proportion because of increase in production. It is therefore illegitimate to enunciate a quantity theory of mathematical accuracy. Ordinarily it is impossible to have a situation of other things, specially commodity supply, remaining the same when money increases. Quantity theory is applicable only under imaginary circumstances and has no connection with the realities of the economic world.

Members of an economic society earn their income as wage, profit, interest and rent. Begged and robbed amounts are derived from the members of the society who earn their incomes in any, some or all of the first four forms. Now a labourer can get wage as long as he is engaged in production, a businessman can earn his profit as long as he is engaged in organizing production. Capital of a man can earn interest only when it is taking part in production and land yields rent when it is engaged in some sort of production. Production in turn is the resultant of the combination of the four factors: land, labour, capital and organization. The expenses of production are therefore the sum-total of wage, profit, interest, and rent. Thus the total cost of production of all the commodities, is equal to the total income of all the members of a society. The entrepreneurs must sell their commodities, at cost price and this means that they must get back the entire income of the society in exchange of their commodities. But we know that human beings, as they are constituted, do not spend the whole of their earnings but set apart and save, a part of their

income. This withdrawal of a part of their income puts the entrepreneurs into losses and they have to reduce their scale of operation. This throws some men out of employment which in turn reduces demand for consumption commodities because the unemployed men cannot buy things. This again reduces production and employment further and the vicious circle continues. With the reduction of production, income also is reduced, bringing down saving with it. But as long as there is any saving whatsoever, losses of businessmen will continue and in the long run production will cease altogether and all the persons of the society will die of starvation. But this extreme consummation of saving propensity assumes that every unemployed man ceases to consume things and probably ceases to exist. But this is not really the case. The unemployed men will live upon their accumulated reserves and capital or will depend on state subvention or charity. In otherwards, their demand for consumption commodities will involve negative saving on their part or on the part of other members of society. Falling prices will also force the employers to reduce wage rate and to the extent this attempt is successful, income is reduced but saving is reduced more than in proportion because consumption of people has the first claim on their income and when the income suddenly falls, only saving has to feel its first brunt. When the negative savings of some just balance the diminished savings of others, the entrepreneurs get back their entire expenditure. Net saving is reduced to zero and people are forced down to the barest minimum of subsistence.

There is another way out of this difficulty. If the entrepreneurs devote their resources partially to the production of capital goods and these investments just balance the savings of society, they will get back the whole their expenditure. The expenses of production are distributed in the same proportion as the income earners are willing to buy consumption goods and to save. Savings just balance investments. Investments have thus preserved the savings of society by the full amount. Starting from the position of zero net saving if we imagine that money is being advanced to entrepreneurs in increasing amounts for investing in the production of capital goods we shall see that at every stage the savings created will exactly equate the volume of investment. A small instalment of investment of this kind will give employment to some unemployed persons and will increase income by the exact amount. If we assume that the newly employed persons spend the whole of their income on consumption, price of consumption goods will be stimulated and if the labourers are equally efficient another batch of unemployed labourers of equal number will be employed. To produce the consumption commodities of this second batch, a third batch of equal number will get employment and so on till all the unemployed get employment. Thereafter increase of production and employment will automatically stop.

But the newly employed labourers do not consume the whole of their income but save a part. Hence the second, third and such other batches of persons getting employment in the production of consumption commodities for the previous batches will make an

everdiminishing series and as such production and employment will not increase indefinitely. Of course, production and employment will be several times as big as the initial investment and employment. The number by which the original investment and employment is to be multiplied to arrive at the total increase of investment and employment has been happily termed 'multiplier' by Mr. R. F. Kahn.<sup>1</sup> This multiplier will be a very big number if the percentage of consumption is very large and the percentage of saving is very small. The number will be small under the reverse circumstances. Whether the multiplier is big or small, the total volume of saving must be equal to the original investment. Till saving becomes equal to investment, prices of consumption goods will be higher than cost. Why this should be so will be clear to the reader if he reasons along following lines: Total cost of the entrepreneurs is necessarily equal to the total income of the society. Total cost is divided into cost of consumption goods and cost of capital goods. Total income is divided into expenditure on consumption and saving. Now, if and as long as saving is smaller than investment, expenditure on consumption will be greater than cost of consumption goods. Higher prices of consumption goods will increase production and thereby will increase income. Increase of income will increase saving as well. This process will continue till saving becomes equal to investment. Again, saving cannot become greater than investment because in that case prices of consumption goods will fall below

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1. Keynes: *Theory of Employment, Interest and Money*, page 113.

cost. Saving being greater than investment, expenditure on consumption will be smaller than the cost of consumption goods. This will reduce the scale of production of consumption goods and therewith income and saving. This process will continue till saving is reduced to the level of investment again. Thus we find that saving is the creation of investment and not vice versa. Saving is a passive factor while investment is an active factor. Investment multiplies production, employment and income several times as big as its original volume. This multiplier is big where per capita income is low and people have to consume bulk of their income and there is very little margin to save.

If investment be made to increase gradually, production and employment will go on increasing in multiples of investment till the level of full employment is attained. At this point physical limits to further expansion of production is reached. The monetary authority, by increasing money supply can very easily increase investment and thereby production and employment. Supply of money is most intimately connected with national dividend, money supply being the, or one of the, determinants of the national dividend. Mercantilists, without understanding it, seemed to have enunciated a very correct theory.

Increased supply of money, will not necessarily lead to the increase of price level. If increased supply of money is utilised in increasing investment, commodity supply will increase *pari passu* with money supply. With every increase of investment, when equilibrium is attained, things will be sold at cost prices. Assuming things in general to be produced at constant cost,

prices will not rise at all. This will be the case at equilibrium after every fresh increase of investment and price level will be constant as long as there is any unemployment at all. But when the level of full employment is reached any further attempt of increasing investment by increasing money supply will be abortive. New investment will then be possible only by diverting labourers from their previous employments and in doing so they are to be offered higher salary. Investment cannot exist by itself and it has to be worked up by labourers. Full employment level therefore marks the last line of increase of investment. Any further increase of money, because it cannot increase commodity, will raise price level proportionately. Quantity theory is applicable only after the full employment is reached. Before this point, increase of money can be made to increase investment and through that, production and employment only. It will have absolutely no influence on price level. Of course, if with the increasing supply of commodities, cost of production increases, price level will rise but this is the action of diminishing returns in production and not due to increase of money supply. Again, if with increasing supply, cost of production comes down, price level will fall. None of these however is caused by monetary influences.

In the post-War years unemployment has mounted up to colossal figures in almost all the countries of the world. Increase of money and investment at the present time will not raise price level, provided sufficient time is allowed for economic forces to work out their results. It will simply increase production

and employment. In India the gravity of unemployment problem is not generally realized. Discussions on this point, are concentrated on middle class unemployment only. But there is a huge volume of unemployment amongst rural masses. It is a common theme of Indian economists that there is a vast volume of surplus population on agriculture. Even the most modest estimation of this surplus population borders about ten crores. Again, the agricultural workers are kept engaged only for five months in the year. They virtually idle away the rest of the year. They are only partly employed. If money be forthcoming to provide employment by organizing capitalistic industries for the surplus population now over-burdening agriculture and cottage industries are organised to provide off-time employment to the rest and scientific methods are adopted in agriculture, production can be increased in India on a hitherto undreamt of scale. And if this industrial regeneration is undertaken at a slow speed, there is no ground for apprehension of any appreciable rise of prices. To provide full employment in India, investment need not be on a huge scale because Indians have very little margin to save and consume the bulk of their income. Investment multiplier in India is very great because of this small margin of saving.

The art of monetary management has been perfected to a very high degree in the modern age. It is now realized that as long as the Government can maintain its authority, it can have anything accepted as money. At the present moment, medium of exchange of the world is paper. There is no cost

involved in increasing the supply of paper money. It is possible to increase investment if this paper purchasing power can be placed in the hands of entrepreneurs (and not in the hands of speculators). Increase of investment will increase employment and national dividend but need not necessarily increase price-level.

The most pressing problem of the modern age is unemployment. Modern democracies are being replaced by various forms of socialistic government because the former have not been successful in tackling this problem. If the monetary authorities of capitalistic countries have such an efficient instrument for fighting this evil, they must try this method by all means. They need not be afraid that this new obligation may involve the monetary authorities to a more intricate management of the currency.

## CHAPTER X

### The Nature of Money

It has, by now, been made sufficiently clear that the volume of employment and production depends on the volume of investment. Investment can be increased if more purchasing power can be placed in the hands of entrepreneurs. In good old days increase of purchasing power i.e. the supply of money could be effected only by importing more specie. Banking was ill-developed in those days and currency notes also were of very limited circulation. It was not possible to have any large supply of paper money for the simplest reason that neither the credit of the governments on which currency note circulation depends nor the credit of banks on which cheque circulation depends, was of unimpeachable character. But nowadays the situation is quite different. Nearly the whole of circulating medium consists of notes and cheques in a civilised country. Metallic coins are generally overvalued subsidiary money for small transactions. In England about 95 per cent. of the total transactions are effected by cheques only, while in America the percentage is probably higher still. The rest of the transactions in England are done by notes mainly and by metallic subsidiary coins to a very slight extent. In India also about one half of the circulating medium now consists of notes and cheques but cheque money, though prevalent in the big commercial centres, has not made sufficient headway.

After the establishment of the Reserve Bank in 1935 it is expected that paper money will occupy a much more prominent position. Anyway, the point to be investigated is whether the volume of paper part of currency depends on the metallic part and if so the total volume of money necessarily depends on the supply of specie in a country and as such the monetary authority has very little to do in the increase or decrease of money supply. Let us first take cheque money into consideration. A cheque is a letter addressed to a bank and written by a depositor of the bank, to pay to the bearer of the cheque, the amount of money written on it, from the deposit he has got with the bank. The right to draw a cheque can therefore be acquired only by depositors. Depositors are necessarily those persons who have kept money with the bank. Banks' lending power therefore is strictly limited by the amounts of deposits and the monetary authority has therefore no power to increase the supply of cheque-money.

But there is another point to be considered. Loans are possible not only when there are pre-existing deposits but also when there are no deposits. Loans can be sanctioned by a bank in anticipation of deposits forthcoming in future. Let us suppose that a bank has no surplus deposit for the time being but even then it sanctions a loan to one Mr. A. Cheque paying banks, to use the name suggested by Withers, grant loans in the form of deposits. The borrower, Mr. A, gets a deposit of the borrowed amount with the bank. The borrower, of course, has borrowed the amount to purchase something. Probably he spends

the whole sum the next day and pays the bill by drawing a cheque on the bank and the receiver deposits it in his name and the bank simply transfers the deposit from A's account to the account of the receiver. Thus we find that a deposit has been created in consequence of the loan and not the vice versa. The receiver of the cheque, say Mr. B, may spend the amount himself but whoever receives the cheque, deposits it in his name and there is a net addition of deposits corresponding to the loan.

But difficulty arises when there is not one bank but many banks. Mr. A, may be the customer of bank No. 1 while Mr. B may be the customer of bank No. 2. Mr. B will deposit the cheque with No. 2 bank which will demand and realize the amount from bank No. 1. In this case also, the loan has created deposit, not of the lending bank but of another bank. Similarly a loan of No. 2 bank may create a deposit of No. 1 bank. If both the banks grant loans at the same rate, their mutual demands will cancel each other and there is no limit to loan granting power of the two banks taken together. In place of two banks if we suppose that there are many banks, but they are granting loans at the same rate, there is no limit to the loan granting power of the banking community as a whole.

The unlimited loan granting power of the banks depends on two conditions. In a society where everybody is willing to keep his money with bank and not with himself, cheque money is possible. If on the receipt of a cheque, the receiver wants to encash it and to keep the amount with himself, loans in anticipa-

tion of deposits become out of question. This bank-mindedness is the prime requisite of cheque money. Secondly a seller will not receive a cheque from an unknown person unless he feels confident that the stranger will not cheat him with a fraudulent or over-drawn cheque. He should again be confident that the bank on which the cheque is drawn will not shut up its doors in the meantime. The acceptance of cheque therefore depends on the double edged confidence on the issuer as well as on the bank. Such a high level of credit is to <sup>be</sup> found only in a society where general public is of the highest possible business integrity and morality. From this dependence of cheque money on the credit of the general public, deposit money has assumed the name, credit money or simply credit.

There is an inherent danger of the cheque money arising from the fact that cheque money is always convertible into legal tender money. If the holders of deposits want to exercise their right and to have in their possession legal tender money bank has no other alternative but to pay the lawful money. Cheque money circulates on the belief that it can, on demand, be converted into legal tender money. As a matter of fact a percentage of transactions in every country is effected by legal tender money and as such a certain number of cheques are always presented for encashment. In a civilised community, the amount of these cheques is not considerable and constitutes a very small percentage of total deposits. But all the banks must keep this percentage of legal tender money to ensure the safety of their entire volume of cheque money. This

is the limit to unlimited money making power of banks; for every loan, they must keep a certain percentage of legal tender money. If 5 per cent. of the cheques are presented for encashment, 5 per cent. of the assets must be kept in banks' vaults in the form of legal tender money. In any case, cheque money can be multiplied twenty times the legal money at the disposal of a bank. This multiplying power also amounts to a power of making money out of nothing to a very great extent in place of unlimited extent.

The second limitation to the unlimited money-making power of banks lies in the volume of security which the borrowers can offer and without which banks cannot grant loans. When the volume of good security increases, banks can manufacture more money and when such security becomes scarce, money making power of the banks is necessarily curtailed.

The two limitations we have discussed are not practically speaking limitations at all. The volume of first class securities has increased tremendously, specially in consequence of colossal amounts of floatations by the Governments during the Great War and after. Secondly banks can multiply money from 15 to 20 times of their holdings of legal cash and reserve requirements constitute a remote limitation of loan granting power which is not generally tested to the limit of its tension. But the real danger of a bank lies in sudden relapses of banking habit of people which occasionally take the banks by surprise. Here we do not like to enter into a discussion about the causes and consequences of a bank crisis but we simply like to state that when such a crisis occurs banks have

to encash cheques, amounting to virtually the whole of their deposit liability. Cent per cent legal tender reserves only constitute adequate safeguard against such a contingency. It is not known beforehand when a crisis will occur and banks must therefore keep always prepared to meet such an eventuality by keeping cent per cent reserve or in default to shut up their doors on the advent of a crisis. But if cent per cent reserves are to be kept, money making power of the bank ceases to exist.

A central bank is rightly considered to be an adequate safeguard against banking crisis. A central bank is the federation of all other banks. All the banks doing banking business in the country must be affiliated to the central bank and are put under legal obligation of keeping with it an account which is a certain percentage of their deposit liabilities. The banks on the other hand, have the privilege of having loans from central bank, whenever they are in difficulty and are in shortage of funds. There are many advantages which a member bank enjoys under the protection of their central bank. If a particular bank becomes indebted to other banks in consequence of granting excessive quantity of loans, it need not be nervous. Such interbank inequalities of demand can be cleared off by drawing a cheque on the central bank and transferring a part or whole of its reserves with the central bank to other creditor banks. Even if a crisis occurs there is nothing to worry about. The banks will be able to encash all their deposit liabilities by drawing cheques on the central bank. If reserves of any bank with the central bank dries up, it can take

a fresh loan and go on drawing cheques. The responsibility of finding legal money will thus be easily shunted off to the central bank. In view of its special responsibility for meeting emergencies and crises central banks all over the world keep a very high percentage of assets, about three times the reserves of other banks, in the form of legal tender cash. This unduly high reserve percentage of the central bank, keeps it above suspicion so far as its solvency is concerned and the public, even in a serious crisis, is not inclined to encash their deposits with the central bank. Internal crisis has become a thing of the past in those countries where there are central banks.

When the crisis is of exceptionally serious nature the solvency of the central bank also may be jeopardised. Even the very high legal tender reserves of the central bank may not be sufficient to meet the occasion. Central bank has yet another very effective weapon for the purpose. Central bank in every country has got the monopoly of note-issue. Circulation of notes depends not only on the credit of the central bank but also on that of the government of the country which has invested in it legal tender character and the currency notes will be accepted by people as long as the government are strong enough to enforce their laws. Of course, under ordinary circumstances, the central bank is not allowed to issue notes indefinitely and the law of the land enforces stringent regulations on this note issuing power. But there are also provisions in these laws, relaxing the stringent regulations to issue notes above statutory limit, to meet grave emergencies. Hence when the central bank is cornered by

the relapse of banking habit of the people it can issue excessive quantity of notes. Cheque money in that case will be replaced by another kind of paper money. We are not however oblivious about the fact that notes are also convertible. If the joint credit of the central bank and government is not sufficient to allay public apprehension, notes also may be presented for encashment. Central bank will generally meet such demands promptly by paying gold for notes. If the gold reserves of the central bank is equal to the total volume of notes and cheques in circulation, it will be able to meet all the demands for encashment. But in that case, the total volume of money will be dependent on the quantity of specie. Though ordinarily central bank reserves are much greater than the minimum required to ensure the encashability of notes and cheques even during a very acute crisis yet the question remains that if the gold reserves be not sufficient, suspension of cash payments will be the inevitable consequence and the charters of the central banks provide for such suspension in case of grave emergencies. The very fact that the central banks can avail of the power of suspension of gold payments is more than sufficient to allay the fears of the most incredulous about the convertibility of cheques of central banks. Suspension of gold payments will mean the sacrifice of gold standard but the safety of banking system and expandibility of money may be more important than gold standard. Nowadays, almost all the countries of the world have given up gold standard and have adopted arbitrary paper standard under which there is no limit to money making power

of the banking community as a whole. The power of making paper money is one of the greatest discoveries the world has ever made; the other discoveries being fire and electricity. This power of money making will probably effect far more changes in the affairs of human beings in future than have been wrought by fire and electricity in the past. This discovery has freed man from the tyranny of gold and silver in bringing about an increase in the supply of money.

The necessity of the present moment is an increase of investment. That will increase national dividend and employment. If purchasing power i.e. money can be placed in the hands of entrepreneurs, investments can be stimulated till the full employment is attained. Increase of money supply is therefore the prime requisite for stimulating investment. But money supply could not be increased in the past due to natural limitations of specie and complete dependence of currency supply on the quantity of gold and silver. But the art of paper money has enabled human beings to increase money with paper only and virtually out of nothing. Thus investment has become controllable by the banking community and the volume of money can be so regulated as to have full employment for the society. But how can the money be transferred and placed at the disposal of the entrepreneurs? Should it be handed over to them for good? As the banking community can make money out of nothing, it seems that transfer of money to the entrepreneurs for good will not mean any loss to the former. But is it really the case? Let us take the case of cheque money first. Is it possible

for a cheque-paying-bank to grant a loan to an entrepreneur and afford to forget about it in future? In other words, can it afford to hand it over for good?

Bank is rightly described as a middleman between lenders and borrowers. It collects money from some to lend it to others. So far as spontaneous deposits of the public are concerned, this description of the bank is quite accurate. But there is some difficulty to understand the middleman nature of a bank so far as loans in anticipation of deposits are concerned. But the difficulty is rather superficial than real. Let us suppose that Mr. A, has borrowed from a bank Rs. 100 with which he has bought a cycle from Mr. B, who after receiving a cheque of Rs. 100 from A, deposits it with the bank. Now, A owes to the bank Rs. 100, and the bank owes to B Rs. 100. B thinks that he has received the price of the cycle but as a matter of fact he has simply received a promise from the bank that he will be paid the amount whenever he demands it. In other words he has sold the cycle on credit to A on the security of the bank. This is the same thing as saying that the bank has lent to A the money belonging to B. If the bank cannot realise its loans from A, it will not be able to meet the cheque from B which is bound to be presented sooner or later. Hence, cheque money is essentially of the nature of a loan and as such it can be placed at the disposal of the entrepreneurs, only in the form of loans to be realized when the productive process is over.

Currency note also is essentially of the same nature. The crudest way of issuing currency notes

is the printing of notes by the government and spending those for their own purposes. The holders of these notes which are legal tender money, cannot present them to the government and demand full value in terms of gold or other commodities. Here we are of course considering the case of inconvertible money. But even in this case, these papers remain as the evidences of loans taken by the government from the holders of these papers. The present holders of currency notes are holding these not to eat or wear but to buy commodities in exchange of those papers. These notes will therefore move from one man to another and will effect necessary transactions for different persons. When the transactions for all the persons are over nobody will hold this money any more. But the question is, who is to hold it? It cannot be forced back on the government because it is legal money. But the fact that it is legal tender money will make the government powerless when government dues will be paid in terms of these notes and the issuer gets back its own issues. If the government refuses to accept these notes in discharge of public dues, they will fall down in the estimation of the public and will lose their general acceptability character. The holders of money will not be able to purchase things with these as they expected and for which they accepted these papers by selling their own things. What the government gains will be lost by these people and it amounts to a repudiation of debt. If at the time of the issue of paper notes, it was known that the government would not accept those in discharge of public dues, nobody would sell anything in exchange of those papers and the government would

not be able to put those in circulation but at the point of bayonet.

When the issuing authority is a bank, the credit nature of the notes is still more apparent. Let us suppose that the bank has issued some currency notes and has either purchased things with those or has lent those to somebody. In any case, the holders of those currency notes are the lenders of so much money to the bank. When the bank has lent this money to some, its dues from those, are balanced by its liability to the holders of notes. When those notes have effected all the transactions they are required to do, there will no more be any holders of those monies which will be dumped back to the bank. If the bank be unwilling to accept these at their full value, last holders of these monies will be ruined and it will amount to the repudiation of bank's debts. Hence the notes are the evidences of loans of the issuer to the holders of those notes and as such the increase of such note money can be effected only in the form of loans to be realized after the end of productive processes.

A certain number of notes however will be constantly on move from one person to another and at no moment these will be squeezed out of society. When somebody has done away with those, others will be in need of them to effect transactions. For this reason it is possible for the issuer of the notes to be oblivious about that amount of note circulation which will not be redundant under any circumstances. This amount of loans can be issued and its realization is not essential for the safety and credit of the issuer. But the

amount of such loans is not very big and almost all the governments of the world have helped themselves in taking substantial parts of these loans in perpetuity by authorising the central banks to issue notes against such loans. These are popularly known as the fiduciary parts of note issue. But though the fiduciary notes are not likely to be presented for encashment, still their loan nature should not be forgotten. These may be termed as loans in perpetuity granted by the holders of these notes to government or to bank. Under changed circumstances even a part of these fiduciary notes may become redundant and the issuer may have to reabsorb them for the sake of its credit.

Full valued metallic coins also are evidences of loans granted by the holders of money to the issuer of those coins. Money has only value in exchange and has no value in use. People accept these coins in exchange of their commodities for the simplest reason that they are able to purchase things they require in exchange of that money. People cannot eat or wear money. If we imagine that all the transactions that are to be effected, have been effected at a particular moment, even full valued coins are bound to be redundant. The issuer in that case has got to reabsorb those by paying full value or these will lose their value altogether and the then holders will suffer a complete capital loss. It will be tantamount to the repudiation of a public debt.

Thus we find that money, whether deposit money, currency note, subsidiary coin or full valued metallic coin, is essentially a credit, an evidence of a loan. The

issuer of the money owes it to the holder of that money. Some of these loan-deeds are likely to be and are generally presented for settlement very promptly while others are presented after a longer or shorter period. Some are loans virtually in perpetuity. But loans are they all and they carry with them the obligation of repayment by the issuer. Hence if money supply is to be increased to stimulate investment, the monetary authority can do it only in the form of loans and that on full security so that it can be recovered for the liquidation of the debts of monetary authority created in consequence of the manufacture of money.

Loans have been always and are now attended with interest charges. Holders of deposit money receive very low rate of interest from banks who extort higher interest on their lendings. Holders of currency notes, subsidiary coins and full valued coins do not and from the nature of these cannot charge any interest from their issuers who however charge interest when they lend these to others. From the standpoint of the borrowers cheque money and legal tender money are the same and a uniform rate of interest is established all over the market for the borrower of the same rank of credit and for the loans of same duration. Thus we see that the issuers of money are to pay little or no interest while they charge a high rate of interest from their borrowers. We have seen that recovery of loan is an essential condition of making money but can we say with equal force that recovery of interest also is an essential condition of making money?

Can't the lenders afford to manage without interest? We have already seen that the banking

community as a whole can make money out of nothing to a very great extent. I consider this to be the, at least one of the, greatest discoveries of the world. As this money can be made out of nothing, in other words, as these amounts are collected from people without any effort on behalf of the banking community, interest should not be charged for loans.

It is however maintained that the money lent by the banking community comes ultimately from the savers who will not save unless they receive interest. If bank lend money without interest, the newly made money will not find savers to settle down and will promptly come back to the bank for cancellation. Obviously, this seems to be plausible. But there is another and more likely possibility. If the newly made money is engaged in investment and production, saving will increase *pari passu*. The same amount of saving will be created by the act of investment itself and this has been explained in detail in the previous chapter. Hence the apprehension that the newly made money will not find saving to settle down unless some interest is charged on loans is absolutely baseless. Probably it is true that a higher rate of interest stimulates a person to save something more than he was saving before at a lower rate of interest with the same income, while a low rate of interest tends to diminish his savings to some extent. But it should be remembered that a person cannot save the whole of his income even if the rate of interest is infinity and he will not cease saving altogether when interest rate is zero or even negative. Interest at most is a very minor determinant of saving which is mainly regulated by the volume of national

dividend. National dividend and production can be increased by increasing investment which again can be stimulated by making money. Thus we find that the manufacture of money will create its own savings for settling down. There can therefore be no objection in forgoing interest so far as the bankers are concerned because they can, on the whole, make money out of nothing.

Though the banking community can afford to forgo interest still banking being a very closely organized and monopoly industry, hardly ever lowers interest rate to a very low level. Of course, banks do not fix interest rate with the sole aim of maximising dividend but they work partly under the misconceived notion of safeguarding saving and partly under their selfish motive of profit, and generally maintain a rather high rate of interest.

Thus so far as the supply of money is concerned we find that it is a monopoly product having virtually no cost of production and as such interest charge for lending is generally kept higher. Let us examine the condition of demand for money. The demand for money evolves out of needs for money on several accounts. First of all, people require money for bridging the gap between the time of expenditure and the time of receiving one's income. The strength of such demand for money depends on the amount of income and the length of time between the receipt and expenditure of income. Again, businessmen require money to bridge the interval between the time of incurring cost to produce things and the time of the receipt of sale proceeds. The strength of this demand also, depends

on the volume of production and therefore on national dividend. Thirdly people keep a part of their saving in the form of money to meet unforeseen contingencies. If the entire saving is locked up in long term investments and if he suddenly requires some liquid money and is forced to sell that investment he may suffer losses if the rate of interest fluctuates. The possibility of fluctuations in the rate of interest is the source of this demand for money. The demand for money for personal expenditure, business expenditure and unforeseen expenditure depends on the current output and the volume of national income. Higher or lower rate of interest will not appreciably affect the volume of demand for money on these accounts.

But there is still another source of demand for money, originating from the fluctuations in the rate of interest and this may be termed speculative demand. In those countries where there are 'organised markets for dealing in debts' i.e. where there are closely organised banking system having cheque paying banks, bill-brokers, discount houses, accepting houses and a central bank as well as produce and stock exchanges, a huge volume of money is demanded for speculative purposes. Different persons will estimate differently about the probabilities of future course of interest rate but the market as a whole work according to a convention that the existing rate of interest will continue indefinitely and the surrounding conditions giving rise to that interest rate will remain as they are unless unexpected happens. Any person who thinks that the rate of interest will be lower than what the market has fixed up, will be tempted to keep his resources in investment

form and his demand for money will be correspondingly reduced. On the other hand if he thinks that the rate of interest will be higher than the market estimates he will keep his resources in money form. This will increase his demand for money. An illustration will clear the point. Let us suppose that the market estimation of the interest is 5 per cent. per annum. If a person thinks that the rate will be  $2\frac{1}{2}$  p. c. per annum in the near future, he will try to purchase real property and investment. The value of these investments will become double according to his estimates and if that materializes he will be able to earn a huge profit. This anticipation makes the person a bull. On the other hand, if he thinks that the rate of interest will be 10 per cent per annum, he will dispose of his investments because according to his expectations their value will become half. This will turn him a bear. In the former case he will part with his money for investment while in the latter case he will part with investment for money. When the rate of interest rises, the number of people who thinks it will fall, gradually increases. The demand for parting with ready cash and procuring investment will increase. In otherwords, the amount of cash demanded at the higher rate of interest will gradually decline. When the rate of interest falls, the number of speculators who think that it will rise again, gradually increases and the demand for disposing of investments and procuring cash increases, in other words, the amount of cash demanded at the lower rate interest, will gradually increase.

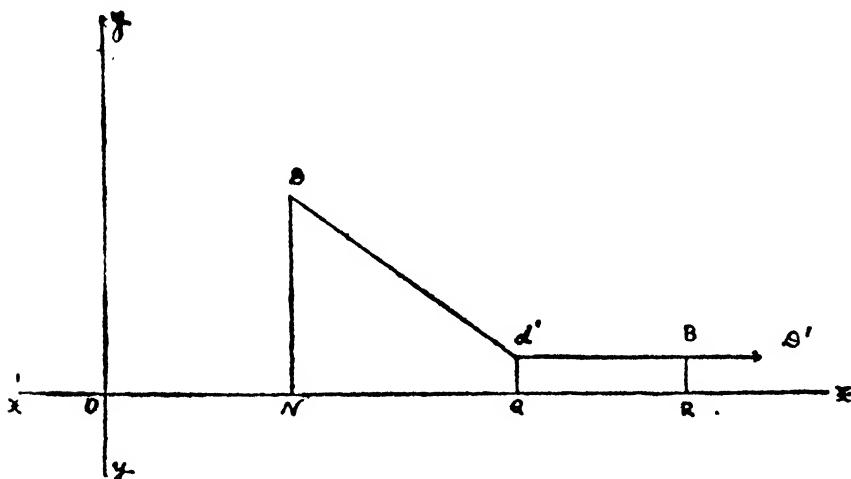
Thus we find that the demand for money to satisfy income motive, business motive and precau-

tionary motive is independent of interest rate and depends on the general condition of economic activities of the society and the value of current output or national dividend. But so far as the money demanded for speculative purposes is concerned, the rate of interest is the only determinant of the volume of that demand. Any way, we can sum up the whole situation by enunciating a general principle that the volume of money demanded increases with a lower rate of interest and decreases with a higher rate of interest. The final rate of interest is determined at the point where the willingness of the banks to supply a quantity of money at a particular rate of interest just equalises the quantity of money demanded by people at that rate of interest.

Organised markets for dealing with debts in modern societies have imparted an amount of liquidity in investments that was unknown before. It is quite possible to dispose of an investment at a practically moment's notice. This liquidity of investments has considerably diminished the demand for money for emergency needs. But all the real properties and investments are not as liquid as the best in their lot. Again possibility of any upward movement of interest imparts an element of risk and loss in such a sudden disposal. For these reasons demand for money for emergency needs, though less than what it would be otherwise, is of considerable dimension. But the possibility of profit and loss in the capital valuation of the investments provides the motive of demand for money for speculative purposes. When the interest rate falls lower and lower, a point comes when almost

all the people think that further investment involves the possibility of a greater loss than keeping the resources in money form. The demand for money at this or any lower rate of interest is unlimited.

Mr. Keynes thinks that the real cause of such a demand for unlimited amount of money at a certain low level of interest lies in the characteristics of money which satisfy liquidity preference. As people think and rightly that money can purchase anything at any moment, they are always ready to pay some interest for that liquidity itself. World is really deeply indebted to Mr. Keynes for supplying this idea of liquidity, throwing considerable light in the vexed problem of interest and for solving a standing puzzle. But here he seems to have overstated his case. At a certain low level of interest unlimited amount of money is demanded and this is not because money possesses liquidity per excellence and can purchase anything at any moment but because at this point possibility of loss in investment from the fluctuations of interest rate in future seems to be greater than keeping resources in



money form. We can here attempt a graphical representation of the demand for money.

In the above graph we measure the quantity of money along X co-ordinate and interest along Y co-ordinate. ON amount of money is required to satisfy income motive, business motive and precautionary motive and is unconnected with interest rate, and depends on the general economic activities and current output. Any further amount of money demanded depends on the rate of interest; lower the rate, greater the quantity of money that people require. NQ amount of money will be demanded at a diminishing rate of interest. At the point Q i.e. when the quantity of money is OQ the rate of interest is  $d'Q$ ,  $Qd'$  is the lowest rate of interest at which people consider the locking up of all the resources in money to be less wasteful than having investment. This is the irreducible minimum rate of interest at which people want to keep their resources en-masse in money form. Thereafter the demand line  $d'BD'$  is parallel to X co-ordinate and the arrow point in the demand line indicates that the amount demanded at this minimum rate of interest verges to infinity.

Given the condition of demand for money, or in the language of Keynes, the liquidity preference of society, the rate of interest is determined by the amount of money the monetary authority is willing to supply. If they supply ON amount of money the rate of interest will be DN and if they supply OQ or OR amounts the interest rate will be  $Qd'$ . But as the society is now constituted it is not possible for the rate

of interest to fall below  $Qd'$  by simply increasing the supply of money.

In conclusion we find that the monetary authority can increase the supply of money virtually indefinitely. By doing so they can stimulate investment till full employment is reached. But as money is essentially of the nature of credit, the monetary authority can increase its supply only in loan form, by lending it to entrepreneurs on full security and extorting it back most rigorously after the completion of the productive process. From the side of the monetary authorities there cannot be any objection in lending money without interest because they can make it out of nothing but the demand for money is of such a nature that the amount of money demanded will be unlimited below a certain minimum rate of interest. Hence loans are, as the society is now constituted, to be attended with an interest as well. Money is therefore loan on interest.

## CHAPTER XI

### The Nature of Investments

We have already seen that if the income earners decide to spend the whole of their income on consumption goods at once, the entrepreneurs will get back their entire cost and all workers will have to remain in their employment. The difficulty arises when the income earners do not spend the whole of their incomes on present consumption goods but try to save a part. The entrepreneurs, in that case get less than their cost and reduce the scale of production. People are thrown out of employment in increasing numbers and national dividend decreases. The depression proceeds till the positive savings of some are balanced by negative savings of others i.e. by capital expenditures of others and net saving of the society becomes zero. People become very miserable by unemployment and reduction in the standard of living. The situation improves when entrepreneurs devote their energies not only in the production of present consumption goods but also in the production of future consumption goods; the latter being called investment. As future is unlimited, an immense volume of investment can be undertaken. An investment will increase employment and national dividend several times its original value. Increased national dividend will increase savings as well. As long as saving is less than investment, expenditure on consumption will be greater than the

cost of consumption goods, the production of which will go on increasing. Increased production will increase income and therefore saving. Equilibrium will be attained when saving will become equal to original investment. Saving on the other hand cannot exceed investment as well, because in that case, expenditure on consumption goods will be less than the cost of consumption goods and as such their production will be discouraged. Diminution of production will lead to diminution of income and therefore to a diminution of saving. This will continue till saving becomes again equal to investment. Thus we see that investment preserves the saving of the society and the saving instinct by itself cannot create any saving unless it is backed by investment. Whatever is investment, will be saving. As investment increases employment increases in multiples and persistent increase of investment will increase on employment and production. It is not possible to increase investment beyond the level of full employment. Further investment to produce consumption goods of future shall have to be manned by taking labour from their previous employments which will suffer from shortage of labour. Thus the development of one industry will only be at the expense of others. Hence the level of full employment records the extreme limit of employment and production.

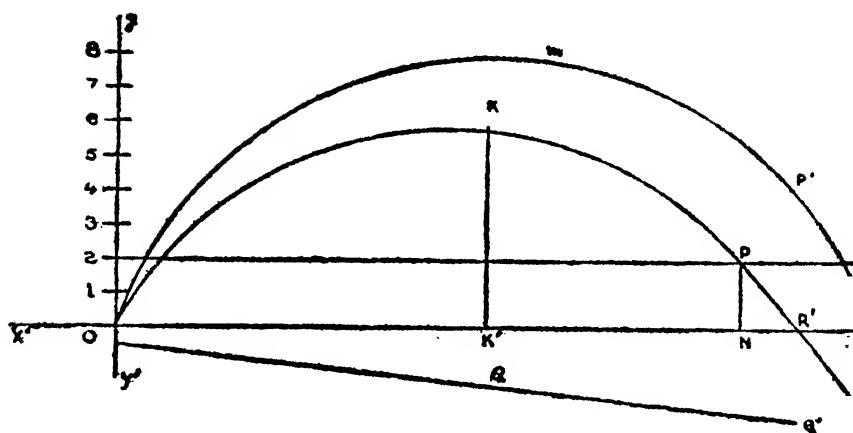
Investment to effect full employment is not likely to be retarded by the consideration of limitation of future demand for consumption goods. Consumption demand of to-morrow or day after to-morrow may be satisfied but there is an infinite number of days, months, years and centuries in future and investment to effect

full employment, how much great it can possibly be, cannot produce all the things of consumption for all days to come. Hence the solution of unemployment problem lies in a persistent increase of investment which will attain, in time, full employment. All the nations should try to attain this ideal level by all means. The monetary authority of a country also should remember this ultimate aim of economic activities and contribute, whatever lies within its power, towards this consummation.

Investment means production spread over time. Productive enterprise is first diverted to produce, not consumption goods in the first instance, but capital goods or instruments of production. When these instruments are complete, they are applied to produce in turn consumption goods. The total volume of labour required first to produce capital goods and then to work those capital goods or machineries, to produce articles of consumption is much less than the volume of labour required to produce that amount of consumption goods by applying labour directly to produce them. This is the same thing as saying that capitalistic method of production is more productive than manual method. Capitalistic method means time requiring process. Time requiring processes are much more efficient than short processes of production. That is why people have taken to machine methods in place of manual methods of production all over the world. This is further proved by increase of per capita productivity and a very great fall in the cost of production of commodities at the present time in comparison with

the pre-machine days. Day by day production is becoming more lengthy, capitalistic, round about and more efficient. There is a general consensus of opinion that lengthier and more capitalistic a production system, more efficient does it become. But there is another aspect of this picture.

It is true that some lengthy processes are more efficient than short processes but that is only to a degree. It is not always the case that lengthier the process more efficient it is. With the lengthening of process there is also wasting and depreciation charge increasing *pari passu*. With longer process productivity increases only upto a limit. Thereafter productivity gradually diminishes. Now, capital goods are said to be productive only when they yield during the whole of their life an amount of product having a greater present value than its cost of production. This excess productivity gradually increases as the process of production becomes lengthier and more capitalistic. Wasting and depreciation caused by time are less than the increase of productivity by the capitalistic method upto this point. After this, lengthy processes do not become physically more efficient and wasting with time at a compound interest is superimposed on those. A point arrives where increase of productivity ceases altogether and the return from capital goods is just equal to its cost of production. Beyond this point the return from those capital goods will be less than their cost of production. A look at the following graph will clear the point.



Along X co-ordinate of the above graph we measure the volume of investments and along Y co-ordinate we measure productivity and the line OKR' is the productivity curve of more and more capitalistic process of production. When production is made more capitalistic, productivity increases and the highest point is attained with OK' volume of investment. Thereafter productivity gradually decreases and with OR' volume of investment, productivity disappears altogether. Beyond this point productivity curve falls below X co-ordinate signifying that if production is made more lengthy productivity will be negative. Thus it is apparent that investment is not worthwhile in excess of OR', thereafter it becomes a positively losing affair. If a volume of investment equal to OR' or less than OR' is sufficient to attain full employment, this behaviour of capital will not cause any anxiety. But if full employment needs a volume of employment greater than OR', unemployment will be an incurable disease because nobody can be persuaded to invest at a positive loss.

In the previous chapter we saw that by nature, money is a loan on interest and that there is a minimum rate below which interest never sinks. If investment is to be stimulated by manufacturing money, the newly manufactured money can be placed at the disposal of the entrepreneurs only in the form of loans at a rate of interest. Let us suppose that 2 per cent per annum is the minimum rate below which interest does not fall. Now, this interest also is to be deducted together with the wasting with time from the productivity of capital to arrive at the net productivity. Investment is therefore possible only to the limit at which the productivity of capital is at least equal to the current rate of interest. If productivity be lower, it will not be worthwhile to the entrepreneurs to borrow money at a higher rate of interest for the sake of investment. The amount of investment that will be worth while with an interest on money is much smaller than the volume of investment that is worth while with no interest on money. In the above graph ON is the amount of investment possible under competitive economy at an interest PN for money. If this amount of investment is sufficient to secure full employment the difficulty is over. But the non-diminishing characteristic of interest seriously curtail the scope of profitable investment and the probability is that before full employment is attained all such investment will be completely exhausted. The chronic unemployment in all the countries of the world is a proof that the existing rate of interest is higher than the marginal productivity of capital at full employment level. Unless some means be found to lower the rate of interest, it

will not be possible to increase employment and national dividend. Under the present individualistic economy it is unthinkable that the rate of interest will sink down to any level nearing zero because of the peculiar condition of the unlimited demand for money at a minimum rate of interest.

Keynes maintains that the fettish for liquidity, that is, the desire of the people to keep their saving in the form of money or the power to purchase anything at any time is at the root of this trouble of unemployment. The entrepreneurs cannot cater for the demand of the money holders because they cannot produce anything at any moment but can produce only definite things at definite moments. "Unemployment develops, that is to say, because people want the moon," (money i.e. the power to purchase any thing at any moment); while it should be remembered that there no such thing as liquidity in investments and productive processes<sup>1</sup>. If the holders of money decide either to spend the money in consumption or to hold investments instead of money, the difficulty will be over. Holding of money means neither consumption nor investments.

But this view of Keynes seems a bit confusing. In our discussions of the last chapter we have seen that money is essentially a loan operation given by its holders to some other person on the security of a bank or government or both. The loan taker or borrower of that amount must have necessarily borrowed it either for his consumption or for investment purposes.

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<sup>1</sup> Keynes: The General Theory of Employment Interest and Money.

If the moneyholder decided to consume or invest the amount himself, the borrower would have been deprived of his consumption or investment. This decision would simply divert consumption or investment. It should always be remembered that effective net saving is a subsequent affair to actual investment already undertaken. The holders of money have got titles on those investments through their hold on the debtors. They cannot increase net investments by deciding to have those themselves. Money is simply a particular form in which a person can keep his savings. If he keeps his savings in any other form it will not change the situation in the least. Only when a person is not willing to save at all, the situation will be otherwise. But in that case there can not be any question of money saving or investment.

The real difficulty lies in a higher level of interest in comparison with the marginal productivity of capital with full employment. That interest cannot fall below a certain minimum level, is not due to the liquidity of money per excellence but because at a certain minimum level of interest and marginal productivity of capital, money becomes the best form of investment.

That after a certain point money becomes the best form of investment is due to the fact that money is an ideal store of value. Its value does not deteriorate in terms of itself while almost all other things deteriorate or at least require a maintenance charge due to wasting forces of time. Though land and other natural agents of production do not deteriorate with time still continued care and effort are essential conditions for the retention of their productive value intact.

That the value of money is kept fixed in terms of itself is a deliberate choice of humanity which has freed itself from the shackles of barter with the help of money. Money simply greases the machinery of exchange. It serves as the medium of exchange and to serve as such it has got to be also the measure of value. Measure of value cannot be simply, present; it has got to be past, present and future. Men cannot help connecting their present with the past as well as the future. To the extent money is the measure of value of the future it makes a very good store of value. If money is deprived of its characteristic of measure of value of the future, it will react on its characteristic of value of the present and will seriously curtail its effectiveness as medium of exchange. In other words it will force the world back to barter. Barter is a very serious handicap to exchange and the volume of investment would have been on a far smaller scale under barter than it has been possible under money regime. Keynes' hatred towards money is to be deprecated on this ground. Without money and under barter, investment would have been very insignificant. Keynes is very jubilant on Gessel's scheme of stamped money. The scheme involves stamping of money every month or year at some expense to keep it in circulation. Unstamped money will lose its legal tender character. By this stamping method money is to be made to suffer a carrying cost like all other commodities i.e. money is to be reduced to the position of all other commodities. "But there are other difficulties which Keynes (Gessel) did not face."<sup>1</sup> It is really

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\*1. Keynes: Theory of Employment, Interest and Money p. 357.  
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surprising that Keynes could be oblivious of the other consequences of such a drastic step which will force the society back to barter. Monetary regime must not be penalized. It will be curing the disease by killing the patient. Something needs be done to make other investments more lucrative to the entrepreneurs and if that becomes impossible of attainment under money regime, it will be more absurd in a barter regime. It has got to be frankly admitted that here individualistic system cannot deliver the good unaided. State has to intervene. It has to develop investment to the level of full employment by manufacturing money either through banking system or through note money.

That individualistic system has failed to secure a proper volume of investment becomes more glaring when we look to the method of new undertakings. When an entrepreneur makes an investment i.e. purchases a new machine or capital instrument, he acquires the right of all the returns to be yielded by that capital instrument. The returns are not however all present; they are present as well as future. The future returns are not identical with the present even in the physical sense. There are the wasting agents of time as well as the everchanging demand and supply conditions of the commodity. A correct estimation of the future returns and their valuations is almost impossible. The present value of future returns therefore depends on the expectation of the investor. In earlier days investments depended on the strength of persons of active character who obtained a satisfaction in the exercise of business ability rather than earning a

dividend by accurate calculations. The modern investment market has solved this difficult problem in a rather stupid manner. It assumes that the present state of affairs and therefore the returns on investments will continue ad infinitum. On this assumption, all the investments are capitalised, bought and sold. In the modern stock exchanges, investments are being revalued everyday according to their current returns. No sane person, when he is alone, believes that the existing state of affairs and current returns will remain identical for ever but the market as a whole observes this convention most rigorously. When current returns suddenly fall, even for ephemeral reasons, for particular investments or for investments in general, their valuation falls *pari passu*. Their marginal productivity in relation to their cost of reproduction falls and investments on those lines are at once stopped. But when after some time, returns on those improve, their valuations increase and the marginal productivity of those investments in relation to their cost of reproduction improves and there is a hectic investment on those lines. But such a hectic investment is likely to lower the marginal productivity of capital even at the inflated estimate below interest rate current at the moment in the near future and investment will be suddenly dropped.

Again, there are occasional waves of pessimism and optimism affecting the stock exchanges and the generality of investors are bearish or bullish as the case may be. In the first case investments are stopped while in the second it proceeds at a hectic speed. These are due to purely psychological contraction and

expansion of the spirits of the speculators arising from events probably having no connection with investments as such. Thus the business of investments is the most erratic one and is very ill done. Sudden fluctuations in investments sometimes throw thousands of men out of employment and at other times require thousands of persons who cannot be employed, though available, because of lack of adaptability, training and probably shortage of some particular kinds of labourers in key positions. It is not necessarily the case that investments will proceed to a limit where marginal productivity of capital estimated on a rational basis equates the current rate of interest. The marginal productivity of capital estimated on the most erratic basis as described above, equates the current rate of interest. The most well informed speculators also do not devote their energies in scientifically ascertaining the future returns of investments but gauge the changes in surrounding affairs in the immediate future and the re-action of the stock exchange to those changes, slightly ahead of the market. By doing so they can make more money than it is possible to do by ascertaining long run returns of investments and sticking to those. The possibility of mistakes in the latter is much greater than in the former and as such the chances of profits, in buying cheap and selling dear slightly ahead of impending changes, are correspondingly greater. Thus we see that the most well informed speculators simply make a profit at the expense of the miscellaneous speculators but cannot alter the course of expectation of the market which observes its own convention most blindly and thereby leading to the most erratic method of

investment. In the graph of page 189 the line  $OmP'$  represents the productivity curve of investments when the market is bullish and  $QQ'$  represents the productivity curve of a bearish market. In the former case it may approach full employment while in the other case it falls below the level of equilibrium between marginal productivity of capital and the rate of interest and returns from all investments not only disappear but become negative. This erratic course of investments in an individualistic economy supplies a special justification of state intervention in this field and convinces the most obdurate that investment on which depends the volume of employment and national dividend, must not be left to private enterprise.

At this stage we are in a position to understand the effects of increase or decrease in the volume of money on production, employment and national dividend. Taking the latter case first we see that a decrease in the volume of money raises interest rate at once. This leads to the curtailment of investment, employment and national dividend. Diminution of money also leads to fall of prices and consequently business losses. This leads to a diminution of marginal productivity of capital. We have already seen that under ordinary circumstances, investment stops at a point where marginal productivity is just equal to the current rate of interest. When investment is stopped before marginal productivity is reduced to interest level, the difference measures the excess profit to the investor and that stimulates investment further. From the time of incurring expenditure for investment

to the time of the disposal of finished goods, if prices fall and the extent of this fall be equal to or greater than the gain from excess marginal productivity of investment, further investment will cease to be worthwhile. This is the same thing as saying that falling prices diminish marginal productivity of capital. This diminution of marginal productivity is the result of falling prices and not a low level of prices. After the beginning of the second productive process if the fall of prices suddenly stops, further investments will become profitable because there will remain nothing to offset the gain from excess marginal productivity of capital over interest. Thus we find that diminution of money supply leads simultaneously to increase of interest and lowering of marginal productivity of capital, reducing thereby employment, national dividend and business activity. From the fall of prices labourers gain at the expense of the entrepreneurs because their wages lag behind prices but this gain is much smaller than the volume of wage, lost by labourers who have been rendered unemployed by the fall of prices and marginal productivity on the one hand and the rise of interest on the other. Diminution of money therefore is a national calamity and must be avoided by all means. Here we find that historical incidents of scarcity of money lend support to this theoretical inference. Abrogation of bimetallism in Europe and America in the early seventies led to a serious scarcity of money. This led to a rise in the rate of interest and a fall in prices in Europe and America and they suffered the worst economic depression in their history. Demonetization

of gold in India created a serious monetary crisis after 1835 and brought for India immense miseries. Again, suspension of silver minting in India in 1893, created a great monetary stringency during the concluding years of the 19th century. Prices fell and interest rose up to 16 per cent. per annum. Trade of India, specially export trade, shrunk abnormally. Agriculture and industry suffered their worst depression and India was subjected to widespread famines intermittently for four years. Diminution of money supply after 1920 and specially after 1929 has subjected Europe, America and India to a very serious economic depression in the present day.

A persistently increasing money supply, on the other hand, leads to increasing volume of investment and national dividend. To the extent the existing rate of interest is higher than the minimum possible rate, the increasing volume of money tends to depress the rate towards that minimum and thereby stimulates investment. Rising prices on the other hand, provides an additional and by far a greater stimulus to production. Under ordinary circumstances investment stops at a point where marginal productivity is just equal to the current rate of interest. If investment is pushed further, marginal productivity sinks below this level and the difference between marginal productivity and the rate of interest measures the loss of the investor. From the time of incurring expenditure for investment to the time of the disposal of finished goods, if prices rise and the extent of this rise be equal to or greater than the loss from the diminution of marginal productivity of excess investment, such investments

will be worth while. This is the samething as saying that rising prices increase marginal productivity of capital. This increase of marginal productivity is the result of rising prices and not a high level of prices. After the beginning of the second productive precess if the rise of prices suddenly stops, excess investments will become unprofitable because there will remain nothing to set off the loss from the diminution of productivity of capital.

That rising prices can make excess investments under ordinary circumstances worthwhile is due to the diminution of the purchasing power of money. The expenses of the entrepreneurs ordinarily lag behind rising prices. Even if the wages and other expenses are supposed to be rising *pari passu* with rising prices, still the entrepreneurs gain from rising prices mainly due to the fact that all his borrowings are in terms of money and those loans are now paid off in terms of money. Thus the extra-gain which the entrepreneur derives from rising prices is at the expense of his creditors and long contract suppliers of his premises and raw materials, as well as long contract workers. How far the maintenance of excess investments that will not stand in ordinary times, is desirable at the expense of creditors is an open question. But this also should be remembered that the stimulation of investment by lowering interest is similarly at the expense of creditors. If it were possible to reduce the rate of interest *pari passu* with the diminution of marginal productivity of increasing investments, new investments would be worthwhile. Even in this case, investments would be at the ex-

pense of capitalists who would not derive the same return from capital which they would have done if interest remained at the higher level. But the stimulation of investment by lowering interest is justified from the fact that creation or collection of money can be effected without any expense or trouble and as such lenders are not justified in extorting any interest from the borrower. In other words the lender of money at interest is a class eminently deserving to be expropriated by all possible methods. Increase of money and rising prices provide an ideal opportunity to do this. But to make such a policy successful, rise of prices must be made continuous and persisting. The shortcoming of such a scheme lies in the fact that increase of money and rise of prices are generally sporadic and accidental and are not undertaken with the aim of stimulating investment. In the past, increases of money were accidental to the discoveries of gold and silver mines. In the modern days, inflation is undertaken to balance deficit budgets or to finance wars. When the primary causes of these rises of prices disappear, prices stop rising and a huge volume of excess investment becomes at once unprofitable and depression follows, leading to a serious curtailment of production, employment and national dividend. If a policy of rising prices is adopted to stimulate investment, that should be done deliberately and with an amount of persistence. It is imaginable that a deliberate, stiff and persistent inflationary policy may secure full employment.

But objection to such a policy lies in the fact that money is the measure of value and its effectiveness as

such is bound to diminish as a result of a deliberate policy of persistent depreciation in its value. Its effectiveness as the store of value will also disappear and as such people will not readily accept it in exchange of their commodities because by the time they will require to purchase other commodities with that money it will be found that they can purchase lesser amounts than they expected. This will undermine the general acceptability of money and will seriously diminish its worth as the medium of exchange. Due to depreciation, money becomes an unwelcome measure of future value and creditors will gradually attach other conditions to their lendings to safeguard themselves from losses. This will gradually force people to resort to barter more and more and if inflation is resorted to a very great extent money economy will be replaced by barter economy. The policy of inflation therefore generates contradictory forces i.e. profits to the entrepreneurs and difficulties of barter, the latter becoming relatively more and more important than the former with the progress of inflation and after a certain stage, difficulties of barter more than obliterate the profits of entrepreneurs from rising prices. Thereafter rising prices, in place of helping, will retard investments. The difficulties of barter occupy a prominent place in the monetary treatises and we do not like to delineate that oft-told tale. It will suffice to mention that under barter regime it is very difficult to effect exchanges due to the absence of a medium of exchange and a common measure of value. Money facilitates exchange by providing a medium of exchange and a measure of value. People require money not for

direct consumption or production but to facilitate the exchange of things of consumption and production and for this service they are willing to pay interest for the use of money. Robbing money of its exchange facilitating power by a policy of inflation is a retrograde step and creates difficulties at the very root of economic activities which are based on division of labour and exchange.

I beg to point out to Keynes and submit at the tomb of his priest Gessel, that their scheme of stamped money is identical in substance with a policy of inflation which is simpler and easier to adopt than the cumbrous method of stamping money. Both the schemes are open to objection on the ground that they are retrograde steps and bring us back to the inconveniences of barter. Money is not the source of trouble. The situation would be far worse without money and under a barter regime. This far only can be said that money does not go the whole length of procuring full employment investment due to interest on money. The amount of interest measures the extent of friction in effecting exchanges. Money has done something very great in facilitating exchanges and stimulating investment. It can do more in this direction by abrogating interest altogether and making exchanges perfectly frictionless. That this cannot be done is not due to any inherent defect of money but due to the stupid and erratic method of investment, and specially due to the extreme application of individualistic method which here clearly runs counter to the general economic wel-

fare of the society. State intervention in investment is an essential necessity.

Though a policy of inflation is ruinous to investment in the long run still at its first stages and specially when it is not at a violent speed, it can maintain excess investment as long as inflation continues at the same or greater speed and as long as it is not reversed by the inconveniences of barter. Prominent incidents of history lend support to this inference. After the discovery of Spanish American Mines and huge importations of specie to Europe, price-level began to rise and this continued upto the middle of the 18th century. During these two centuries there was a persistent production boom and world trade tended to be knit up more and more in one common economic market. During the next century i.e. from the middle of the 18th century to the middle of the 19th, price level was gradually falling and this was due to the Industrial Revolution which revolutionised the systems of production and transport. Production was on a hitherto undreamt of scale and far exceeded increase of specie. Discovery of Australian and Californian Mines in 1848 and 1849 brought specie supply to par or slightly above par of commodity production and business prosperity continued upto 1873.

Gold production during the closing years of the 19th century, specially from South African Mines began to raise up price level in gold standard countries of the world, including India, and these countries enjoyed industrial and trade prosperity right up to the outbreak of the Great War.

During the War, inflation was taken recourse to in belligerent countries in a very precipitate manner. Neutral countries, where golds of the belligerent were dumped, experienced a similar rise of prices. The abnormal rise of prices however did not increase production to any commensurate extent. This shows that the effectiveness of a policy of inflation in stimulating investment is strictly limited and if pushed very far it creates difficulties of exchange and positively retards investment.

Indian economic history also tells the same tale. Depreciating silver standard from 1873 to 1893 stimulated Indian production and employment to a very great extent. Suspension of silver minting made a huge volume of excess investments unprofitable and India suffered from the worst depression in her history and widespread famines from 1896 to 1900. Gold standard with its slight dose of inflation again stimulated investment in India from 1900 to 1914. Excessive inflation of the War-period however could not stimulate production and investment to any great extent. Suspension of inflation after the War and adoption of appreciating gold standard in 1925 have involved India in the present world economic depression.

Stimulation of investment that took place in the past from increased supplies of money and rises of prices were possible because of accidental nature of those inflations on the one hand and mild doses of inflation on the other. All money treatises worth the name, are one in holding that immodest degrees of inflation bring economic activities to a standstill and discourage investment. Preposterous War infla-

tions corroborate this theoretical inference. Secondly if a deliberate policy of inflation is adopted to stimulate excess investment, people will take rise of prices as a settled fact and sufferers from rise of prices will safeguard themselves against the inroads of depreciating value of money. Long term contract will tend to be settled more and more in kind rather than in money. In otherwords, there would be a retrograde tendency of resorting to barter. If on the other hand inflation be accidental and its future extent and duration be not known, sufferers from it cannot take appropriate steps against it. Moreover, if inflation is of modest degree creditors neglect it more or less. Accidental and modest inflations only, stimulated excess investments in the past and their efficacy as a deliberate policy is very limited to secure any substantial volume of excess investment. The scheme of stamped money, which is an inferior form of inflation, will be able to attain still less.

Though it is not possible to attain full employment by a policy of inflation however steep it may be there is nothing to be dispaired of. The power of monetary authority to make money out of nothing may be quite easily put to the service of investment. Let the monetary authority lend money to the investors without any interest, indefinitely as long as there is any unemployment in the society. This will stimulate investment till the marginal productivity of capital is forced down to zero. Most probably this will emerge in full employment for the society.

Capitalistic system of production has made labourers abjectly dependent on employers for their

employment. Employment of a labourer now-a-days necessitates the co-operation of a substantial amount of capital. If a labour had that amount of capital, he would not have become a labourer. Employers on the other hand collect capital only on payment of interest which therefore measures the extent of friction in the economic transactions of the world and labourers have to pay a toll for this friction in the form of lower wage rate and unemployment. If interest is not to be paid the entrepreneurs are placed in command of all the resources of the society which will be placed at their disposal in their perfect juxtaposition to yield the optimum amount of national dividend with employment for all the members of the society. As long as there is any interest on money, the passage of economic resources from the holders of those to the entrepreneurs will involve a friction and cost, limiting to that extent the best utilization of the economic resources of the society and curtailing therewith the possibility of maximum employment and production.

It is on the other hand not unthinkable that zero rate of interest, leading investment to the level of zero marginal productivity of capital even, is not sufficient to secure full employment for the society. When investment is pushed beyond that limit i.e. when marginal productivity of capital is something negative, full employment is attained. Negative marginal productivity of capital will necessitate negative rate of interest for full employment. In other words, lenders are to lend money and to realise a lesser amount back from the borrowers, the deductions increasing with the length of time. This is clearly impossible with money as

it is. The savers will save only in the form of money and the monetary authority, shall have to bear the burden of the negative amount of productivity. The monetary authority, to recuperate the loss, shall have to adopt a policy of inflation or a scheme of stamped money or the like and by adopting some such method only, the burden can be thrown back on the savers. But full employment with negative marginal productivity of capital has serious drawbacks. Till the zero rate of marginal productivity is attained, national dividend goes on increasing with every increase of investment but any further increase of investment beyond this point leads to a diminished national dividend. Secondly we have already seen that a scheme of stamped money or a deliberate and persistent policy of inflation tends to rob money of its most fundamental virtue i.e. general acceptability in exchange of commodities. It tends to force the society back to barter and increases friction in the passage of commodities from the holders to entrepreneurs and retards investments at an increasing rate. Diminished national dividend due to negative marginal productivity of capital, diminishes all the more due to this cause. The point of zero marginal productivity of capital therefore yields the maximum or optimum amount of national dividend and if with this volume of employment also there remains a superfluous number of persons without employment, they should be maintained at state expense and not by creating employments after reducing investments to negative productivity. The latter policy is far more wasteful to the nation and involves a greater net sacrifice. The state policy should be so framed as to

discourage the continuance of any such superfluous number. By reducing birth rate, population should be brought down to the volume of employment at a zero rate of marginal productivity of capital. Zero marginal productivity of capital is a very happy index of the optimum number of population for a country.

Thus we find that both positive and negative interest involves friction in transactions of economic goods and resources from one person to another and in both the cases the best utilization of the national resources is not attained. Both yield national dividend below the optimum level. Hence the policy of zero rate of interest should be followed by the monetary authorities of all countries, including India.

The bewildered reader may be here asking about the condition of the savers with zero rate of interest. Will they cease saving? We have already seen that saving is the consequence of investment and as such it cannot cease. It is probable that savers will keep their saving in the form of currency only. If they do so, even then they will be in substance the owners of investments. We have seen that every form of money is a loan-deed. The monetary authority will be indebted to the savers for the amounts of their saving. The entrepreneurs will be indebted to the Reserve Bank for that amount and as such it is not difficult to realize that entrepreneurs are working with savers' money. Of course, if the savers hold shares they will hold properties yielding no net income and at the same time yielding during its course of life the original value invested in it.

A practical difficulty must be solved here. How will the monetary authority maintain itself in existence when it will be deprived of its dividend earning power? Financial systems of all the civilized countries of the world are closely organised. After the inauguration of the Reserve Bank of India in 1934 our financial system also has been knit up into a homogeneous whole. Dividend earning power of the Reserve Bank has been fixed up at the maximum level of 6 per cent. per annum. It is an accepted maxim that central banks should not be run with an eye to profit because these are national institutions and as such should be run with the exclusive aim of national interest only. Once this principle has been accepted it will not be very difficult to give effect to the scheme of zero rate of interest which involves application of the nationalistic principle to its logical conclusion. Dividend earning power of the Reserve Bank shall have to be abrogated summarily and the expenses of the Bank met from the state fund. The Reserve Bank is to be entrusted with the duty of financing investments without charging interest in addition to its present duties in which we do not contemplate any change. The necessary modification in the Reserve Bank Act is to be incorporated by an act of the Indian Central Legislature.

To whom should the Reserve Bank lend the money? If it adopts a policy of zero interest to all borrowers, money will be borrowed, together with others, by speculators who will indulge in speculation on a hitherto undreamt of scale. Neither will investment to the extent of loans granted by Reserve Bank be undertaken nor interest rate reduced below the

irreducible minimum rate of interest. This will simply fatten an intermediate class of lenders at the expense of the nation. To obviate this difficulty, the loans of the Reserve Bank should be safeguarded and hedged properly to secure investments to the fullest extent. For this purpose a semi-official National Investment Board should be formed with fifteen members. In this body there should be three representatives of agricultural interests, three to represent industrial interests, three commercial interests, one to represent the banks in the country, two delegates to be chosen by the professors of Economics of the different Universities of India, one delegate of Indian Economic Association, one representative of the Indian Legislature and the Governor of the Reserve Bank, the last named being the president of the Board. The members' tenure will be 3 years, one third retiring every year. They will not be under the Government but will receive salaries from Government. The National Investment Board's main duty will be to prepare a panel of entrepreneurs and to determine the maximum amount which these persons can borrow. They will be assisted in this work by Provincial Investment Boards which will be simply recommendatory bodies to the Indian Board. Only empanelled entrepreneurs will receive loans recommended by the Board from the Reserve Bank without interest. The Board will revise these recommendations after every six months and will be entitled to turn out entrepreneurs from their businesses and to appoint their successors. The businesses will be all mortgaged to the Reserve Bank. An Inspectorate should be organised under the Government to

supervise the investments. So far as the Indian Government is concerned, Income Tax Department should be strengthened to take up this additional burden. Provincial inspectorate should be handed over to the Co-operative Department which should be strengthened to take up this additional duty. Agricultural finances should be managed through Provincial Co-operative Banks. Reserve Bank should be given substantial powers to control the Co-operative Departments and their officers for the purpose. Provincial inspectorate should be strengthened by co-operation from Agricultural, Industrial and Excise Departments of the respective provinces. Inspectorate is to see that every farthing borrowed has been utilised in investments. The Board and inspectorate need not interfere in the actual management of the business but should only see that monies borrowed have been fully invested and the investments are at least just paying their ways. If not, they are to apply remedial measures and those, very sharply.

With the adoption of a policy of zero rate of interest by the Reserve Bank and the formation of the National Investment Board, India will be able, in no time, to attain the optimum level of employment and national dividend. I recommend with all the force I can command that the Government of India should at once adopt this scheme of optimum employment in principle and apply it step by step.

## CHAPTER XII

### The Question of the Standard

The solution of the standard problem by classical economics lies in a fixed value of money. It considers the rising and falling value of money as a matter of indifference so far as the total volume of production and national dividend is concerned, though there may be some arbitrary redistribution of wealth from one person to another. Money is a unit of measurement and it is of no social significance whether that unit is bigger or smaller. If the money unit is bigger, a smaller number of turnovers will suffice to measure a particular thing and if the unit be smaller, a larger number of turnovers will be necessary. But that will mean no gain or loss to the exchangers of things. Of course, if the fact of change in the unit is not known to one party or both the parties or it is so sudden or unexpected that they cannot take any adequate measures against it, then there may be some gains or losses to certain exchangers. But losses of some will be balanced by gains of others and for the society as a whole there is no net loss or gain. Money has therefore no influence on the volume of national dividend.

The heretical branch of economists in which I include mercantilists, Marxian socialists, Gessel, Keynes and his followers, has been systematically maintaining that money plays a real part in determin-

ing the size of national dividend. Rising value of money or falling prices curtail national dividend while falling value of money or rising prices increase national dividend. In short, national dividend varies directly with the volume of money. In our detailed analysis of the nature of money we have seen that there is an element of truth in the assertion of these heretics. With the diminution in the volume of money, prices fall, bringing down profit. This reduces marginal productivity of capital. Diminution of money supply again, raises interest rate. Higher interest rate and lower marginal productivity of capital both conspire to reduce investment and thereby to curtail national dividend.

Increase of money on the other hand raises price-level. Rising prices increase profits and therefore the marginal productivity of capital. Increase of money tends to diminish interest rate, if it be above the minimum but this tendency is often offset by increase of marginal productivity of capital and a greater demand for money. During an investment boom interest tends to increase gradually rather than decline. But anyway, increased marginal productivity of capital and a falling rate of interest, if that occurs to any extent, stimulate investment and increase national dividend. But such a happy consummation depends on two conditions. Increase of money and rise of prices must be an accidental affair, at least people must not have any previous knowledge of the rising prices. If people be aware in advance of the rising prices, those who will be sufferers from rising prices will be able to safeguard themselves by attaching extra conditions in kind to long term

contracts. The second condition is that the increase of money and rise of prices must be on a modest scale. If inflation be on an immodest scale, money becomes worthless as a measure of long term value, long term contract and as a store of value. These will react unfavourably on the general acceptability of money and seriously affect the utility of money as medium of exchange. Thus we see that a deliberate policy of inflation cannot increase investment and national dividend to any appreciable extent, if at all, and when pursued to any degree will create transaction difficulties and will actually retard investments and diminish national dividend.

The opposition of the heretics therefore strengthens the position of classical economists rather than weakens it. From the above analysis it is sufficiently clear that increase or decrease of money in place of being a matter of indifference is of serious consequence to society because both tend to diminish national dividend. Thus the ideal of classical economists, i.e. a fixed value of money and avoidance of both rising and falling prices stands stronger than ever.

Though I have included Keynes and his followers in the heretical branch of economists, still the most appropriate name for them will be New-Classical School of Economists. While the forerunners of Keynes could not supply any scientific analysis for their contention, Keynes has earned the gratitude of the world for his super-brilliant analysis of the factors determining the volume of employment in a society and of the connection between money and interest. He has proved to the satisfaction of all contenders that

unemployment is increasing in the world due to the persistence of a high-conventional level of interest. To provide employment for all the members of the nation, there have to be more investments. But investments yield diminishing returns with their increase. To give employment to all, marginal returns to investments will probably be zero or even less than zero. But as interest rate is not allowed to fall below a conventional level, investment to the full employment extent is not profitable to the entrepreneurs and unemployment has become virtually an incurable social malady.

Keynes holds two of the most important characteristics of money, i.e. general acceptability and a good store of value, responsible for this non-fall of interest rate keeping pace with the fall of marginal productivity of capital. Keynes expresses this in a style which is peculiarly his own and puts these characteristics of money in the portmanteau of the term liquidity. He is inclined to recommend the abrogation of these characteristics of money by adopting Gessel's scheme of Stamped Money or the like. It is at this point that we disagree with Keynes. We have already pointed out that the scheme of stamped money is an inferior form of inflation. Both are open to the same objection that they temper with the fundamental characteristics of money and entangle the society in the difficulties of barter. Attempt at tempering with the fundamental characteristics of money is clearly a retrograde step and will rather diminish investment than increase it. Keynes undoubtedly wants to make money as illiquid as other commodities, in other words, he wants to suppress money altogether. Though he

has avoided saying so openly, that is the inevitable inference from the trend of his writings. Unfortunately he wants to kill the patient to cure the disease. His policy is hopelessly defeatist here.

Not only have we got some criticism to offer about the method of Keynes but we have to question the validity of his aim also. His ideal is full employment and to attain full employment he is ready to have investments to any extent i.e. to the level of zero and if necessary to even negative marginal productivity of capital. Here Keynes is not the same thoroughbred economist as he has been everywhere else. An economist on no account considers employment or activity as an end in itself but considers it as a means to some end. The importance of an economic activity or employment lies in the amount of consumable article or wealth that it will ultimately succeed to produce. Consumption or wealth should be the aim of all employment and economic activities. Keynes is here liable to the blame of confusing means to the end and he should have accepted optimum product as his aim rather than full employment.

As investment goes on increasing marginal productivity diminishes but total product increases. This increase of total product continues till the marginal productivity becomes zero after which marginal productivity becomes negative and the total product begins to decline again. Thus the total product is the greatest when marginal productivity of capital becomes zero. Investment upto zero level of productivity will become feasible only if interest rate becomes zero. If interest be higher than zero, entre-

preneurs will not borrow money to invest and have no net return but at the same time pay some interest. Zero interest only will therefore guarantee maximum product and optimum volume of employment.

The same conclusion is arrived at by a different line of reasoning. It is a common-place of monetary treatises that money was devised to obviate the disadvantages of barter. The inconveniences of barter are mainly three: absence of any medium of exchange, absence of a common measure of value and absence of a good store of value. Under barter regime these inconveniences stand as insuperable obstacles to exchange. Division of labour is conditional on exchange. Unless it is possible to exchange freely the products of different persons, it is not worthwhile to divide occupations into sub-occupations and works into sub-works, because the products of different persons cannot be exchanged and without exchange nobody's product can be completed into finished goods and the advantages of division of labour and machinery cannot be derived. Modern civilization is based on division of labour and machine. Both would be impossible if free exchange of things were not possible.

Money has removed all the three difficulties of barter. It serves as the medium of exchange, measure of value and a good store of value. Money has made possible division of labour and application of machinery by facilitating exchange of the products of different persons. To effect an exchange an amount of money is needed. But under the present condition of society, money can be had only at an interest or the use of money can be had only on a payment. Hence

only those exchanges will be effected, the net utilities from which exceed the rate of interest. But the exchanges, the utilities from which are less than the interest, cannot be effected because those will involve the exchangers into a loss. Hence the latter class of exchanges are barred out by the rate of interest for money. The commodities of those potential exchanges remain with their holders and producers who cannot obviously use those as effectively as their potential buyers could have used. In other words, the utilization of the society's resources stops short of their ideal maximum, because of interest on money. Interest therefore measures the extent of friction in the exchange of commodities. The utilities from the exchange of commodities whose exchange is effected, are reduced by the amount of interest on money required for the exchange. What the money lenders receive is lost by the exchangers. The potential utilities from the exchanges which are debarred by interest rate are lost to the potential exchangers as well as to the society as a whole. Money was devised and is meant for facilitating exchange. Interest therefore stands as an obstacle in the discharge of its exchange facilitating duty of money. Hence money cannot be money as long as there is any interest on money. As long as money can be and is lent on any interest, it is not money but a halfway arrangement between money and barter. To perfect money so that it can make exchanges frictionless, interest must be abrogated. By interest we mean both positive and negative interest. Negative interest also will deprive money of its utility as a store of value, as the measure of value

in long term contract and consequently as the medium of exchange. Negative interest also stands as an obstacle in the discharge of its exchange facilitating function of money. Only zero interest on money can make exchanges perfectly frictionless and assure the best utilization of the national resources. That only will lead to the optimum product for the national resources which is undoubtedly the aim of all economic activities. The number of persons employed at zero rate of interest and with facility for unlimited loans may be called the optimum number of employees. The optimum number of employees with their dependents constitute the optimum population that the resources of a country can maintain with the optimum level of per capita income. If with the optimum level of employment also there remains a superfluous number of persons without employment, they should not be given employment by having more investments which will reduce marginal productivity of capital and will make the national dividend smaller than the optimum. It will be much better that this superfluous number be left unemployed and is maintained by raising subscription, whether voluntary or compulsory, from the employed. This will be a less wasteful method of maintaining them than by giving them employments.

There is no difficulty from the side of monetary authorities in abrogating interest and we have recommended that the Reserve Bank of India should adopt a policy of granting loans indefinitely without interest. In order to assure the utilization of loans in developing investments only, we have proposed a National Investment Board which will protect the loans from

falling in the hands of speculators. The proposals aim at perfecting money and not strangulating money by inflation or stamping. Ours is not a defeatist but a forward policy. These measures will make money what money was devised for and will make exchanges perfectly frictionless.

The inquisitive reader may here ask whether the provision of free loans by the Reserve Bank will not necessarily lead to inflation and whether ours is not the same scheme of Gessel and Keynes put in a more deceptive formula. We request our reader to remember that we have safeguarded the obligation of the Reserve Bank to grant free and unlimited loans by providing that every loan must be spent to the fullest extent in developing investment, that investment so developed must remain mortgaged to the Reserve Bank and that the loan must be recovered after the end of the production process most rigorously. Under these circumstances every loan will create investment *pari passu*. Money side and commodity side of the equation of exchange will increase simultaneously and there is therefore no reason why prices will rise at all. Hence the provision of unlimited and free loans is compatible with nonincrease of price-level. In history there are incontrovertible records of incidents when price level did not rise, rather did fall inspite of a very heavy increase of money supply. After the discovery of Spanish American Mines huge supplies of specie began to pour in Europe and from the beginning of the 16th century to the middle of the 17th, price-level of Europe increased nearly three times. "By the middle of the 17th century something like a state of

equilibrium had been reached. The supplies of specie from the mines, it is true, continued to be as large as they had been since 1545 and even increased somewhat during the eighteenth century. . . . . during the second half of the 17th century and the greater part of the 18th century the range of prices was tolerably stable, with rather a downward than upward trend. During the first half of the 19th century, the trend of prices was distinctly, though not rapidly, downward. This downward movement was not due to any decreased supplies of specie; on the contrary, the production of silver increased considerably, and that of gold held its own. But the great expansion which had followed the Industrial Revolution of the 18th century was in full swing, and the quantity of transaction increased more rapidly than the monetary supplies."\* Thus an increase of money supply does not necessarily lead to rise of prices. If commodity supply increases *pari passu*, rise of prices will be offset. Now, what could be possible by the free play of ungirdled forces from 1650 to 1850, can be made more surely feasible by a strict regulation and guidance of investment. Our recommendations for free and unlimited loans will purify money, rather will make money the real money. They will make exchanges frictionless, lead to the best utilization of the national resources and the optimum national dividend and employment.

This conception of money, the incompatibility of ideal money and interest, can be traced, though in a crude form, right up to Aristotle. He condemned

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\* Taussig, Principles of Economics Vol. I Third Edition p. 255.

lending of money on interest as the worst form of *chrematistique* or false finance. Unfortunately we do not find anything in his writings about recovery of loans from the debtors. Probably he assumed the repayment of loans as a matter of course. If we attribute the latter idea also to Aristotle we find him to recommend the abrogation of positive interest and to discourage negative interest. These two would be sufficient to purify money or to make money the real money. The Medieval Church also condemned interest in the most unequivocal language but it is not clear whether they insisted on repayment of loans to the fullest extent. Probably such a situation did not arise at all to make the priests think over this part of the problem. I must also pay homage to the immortal drama of Shakespeare: The Merchant of Venice. The condemnation of the diabolical interest extortion, which only the mighty pen of Shakespeare could express, found an echo in the hearts of millions of humanity. But the most systematic description of incompatibility of money and interest can be found in the teachings of Prophet Mohammad. Interest has been condemned in the strongest possible language in the Koran while at the same time, the repayment of loans also, has been injunctioned under penalty of eternal hell fire. These amount to tabooing both positive and negative interest making money the real money for which it was devised. Though Karl Marx condemned interest he did not condemn negative interest. He propounded the theory of expropriation which means negative interest cent per cent. Thus he had no idea about ideal money. Gessel and Keynes unfortunately have not

looked to money from this angle and condemned money for its liquidity. Gessel expressly and Keynes impliedly suggested the strangulation of money by stamping or adopting some such method. The real contribution of Keynes lies in distinguishing between marginal efficacy of capital and interest and the obstruction caused by the latter in increasing investment and the volume of employment.

The conception of ideal money necessarily taboos both inflation and deflation. Inflation deprives money of its most fundamental virtues and brings back the difficulties of barter. Diminution of money increases interest and thereby the friction of exchanges. Hence the ideal money cannot allow its value to rise or fall; its value must not fluctuate. This brings us back to the assertion of classical economists who condemn equally both inflation and deflation.

We have already explained that even with the provision of free and unlimited loans there is not likely to be any rise of prices because of increase of investments *pari passu*. There is not any possibility of lent out money to be redundant. After the production process is over, there may be some redundancy of currency but we have safeguarded that also, by strictly providing for recovery of loans immediately after the productive process is over. If any how some redundancy develops, this can be corrected, as redundancy at the present time is corrected, by selling some assets of the monetary authority for money and cancelling that supply of currency. Even if it be decided to retain the present Sterling Exchange Standard of India, giving effect to our recommendations of free and un-

limited loans will not in anyway create difficulty in the exchange mechanism to retain the sterling value of rupee. The loan-money will be kept engaged by the exchanges necessitated by new investments and the rupee reserves and sterling reserves will help the Reserve Bank to increase or decrease the supply of money in India to maintain the sterling value of rupee at 1s. 6d.

The fixed sterling ratio of the rupee that is being maintained now, will not however guarantee a safeguard against rising and falling value of the rupee because sterling itself is liable to fluctuation in value. This brings us face to face with the question of the standard of Indian currency. In relation to what standard should the value of the rupee be kept fixed? Value of rupee should be kept fixed in relation to commodities i.e. the price level of things should be kept fixed. Thus we are forced back to the ideal of classical economists. Index numbers of prices must be kept fixed by manipulating the supply of money. We have seen that the best index numbers are those of the earning of labour or those of the prices of commodities representative of consumption. The clauses 40 and 41 of the Reserve Bank Act of 1934 should be amended accordingly to give effect to our recommendations of this Index Number Standard.

Mr. Lindsay drew up the scheme of Gold Exchange Standard and declared that the Government must adopt his scheme inspite of themselves. To day I declare with the same conviction of Mr. Lindsay that India, nay the whole world, has no other alternative but to adopt this scheme of Ideal Money.

THE END



